# CINCH
## ENERGY CORP.

*Annual Report*
*2005*

Positioned for growth

## *Corporate Profile*

Cinch Energy Corp.'s mission is to grow both production and reserves on a capital efficient basis through exploration/development and strategic acquisitions. Management's goal is to maximize shareholder value, enhancing both the net asset value and cash flows of the Company, while continuing to be a responsible and upstanding corporate citizen.

## *Contents*



## *Abbreviations*

| | |
|---|---|
| $M | thousand dollars |
| ARTC | Alberta Royalty Tax Credit |
| bbl | barrel |
| bbls/d | barrels per day |
| bcf | billion cubic feet |
| boe | barrel of oil equivalent |
| boe/d | barrel of oil equivalent per day |
| btu | British thermal unit |
| bw/d | barrels of water per day |
| Cdn | Canadian |
| established | total proved plus 50% of probable |
| GJ | gigajoule |
| GJs/d | gigajoules per day |
| mbbls | thousand barrels |
| mboe | thousand barrels of oil equivalent |
| mcf | thousand cubic feet |
| mcf/d | thousand cubic feet per day |
| mmbbls | million barrels |
| mmboe | millions of barrels of oil equivalent |
| mmbtu | million British thermal units |
| mmcf | million cubic feet |
| mmcf/d | million cubic feet per day |
| NGLs | natural gas liquids |

### *Notice of AGM*

The Sandman Hotel
888 - 7th Avenue SW
Calgary, AB T2P 3J3

Phone: 403-237-8626

The Great Room 3
Plus 15 level

May 18th at 2:30 PM

| | Three Months Ended December 31 | | Year Ended December 31 | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| Petroleum and natural gas sales, net of transportation and before royalties *($000's)* | **8,323** | 4,033 | **27,413** | 8,215 |
| ***Sales volumes per day*** | | | | |
| Natural gas (mcf/d) | **6,248** | 4,953 | **6,478** | 2,707 |
| Natural gas liquids (bbl/d) | **203** | 155 | **217** | 73 |
| Equivalence at 6:1 (boe/d) | **1,245** | 981 | **1,297** | 525 |
| ***Sales Price*** | | | | |
| Natural gas ($/mcf) | **12.44** | 7.29 | **9.59** | 6.97 |
| Natural gas liquids ($/bbl) | **62.69** | 49.66 | **59.83** | 48.68 |
| Equivalence at 6:1 ($/boe) | **72.68** | 44.70 | **57.90** | 42.79 |
| *NOTE: per share figures reflect a 2.5 for 1 common share consolidation which occurred on August 12, 2004* | | | | |
| | **$** | $ | **$** | $ |
| Funds from operations *(000's)*[(1)] | **4,899** | 1,924 | **15,042** | 3,757 |
| - per share, basic[(1)] | **0.10** | 0.06 | **0.38** | 0.19 |
| - per share, diluted[(1)] | **0.10** | 0.05 | **0.36** | 0.17 |
| Net income *(000's)* | **1,364** | 189 | **3,364** | 99 |
| - per share, basic | **0.03** | 0.01 | **0.08** | 0.00 |
| - per share, diluted | **0.03** | 0.01 | **0.08** | 0.00 |
| Capital expenditures *(000's)* | **11,982** | 11,163 | **36,045** | 16,049 |
| Acquisition *(000's)* | **(15)** | 79 | **1,205** | 48,704 |
| Basic weighted average shares outstanding *(000's)* | **47,813** | 33,331 | **40,047** | 20,054 |
| Net working capital (deficiency) *(000's)* | | | **$** | |
| As at December 31, 2005 | | | **3,490** | |
| As at December 31, 2004 | | | **(14,759)** | |

| | As at March 8, 2006 |
|---|---|
| Common Shares and Special Warrants outstanding | **47,812,632** |
| Dilutives outstanding | |
| - options | **2,453,000** |
| - average exercise price | **2.19** |

(1) Funds from operations is a non-GAAP measure and represents net income before depletion, depreciation, non-cash compensation, future taxes and any other non-cash expenses related to the Company's operations. See further discussion under Non-GAAP measures in the MD&A.

# LETTERS TO SHAREHOLDERS

## CEO'S MESSAGE

First, let me thank you for being an owner of Cinch. If you are an original shareholder, I commend you for your faith and also your patience. If you are a new shareholder, I would thank you for your vision and ask you to be patient. In both cases, I truly believe that you will not be disappointed, for the following reasons:

- We have built a very strong management team at Cinch, from our President, George Ongyerth; CFO, Denise Ramage; VP's Brian McBeath, Brent Gess & Marcus McLafferty; right on through to our Office Manager, Barb Cook. These people, along with the rest of our staff, are exceptionally gifted in their own disciplines and are willing to work tireless hours on your Company's behalf.
- The land position that we have acquired, through the drill bit via farmins, by acquisition (Rio Alto), and at specific land sales, is a tremendous asset that could not be duplicated in today's environment of exceptionally high land prices at Crown sales. These lands would be coveted by any exploration company.
- Our lands are located in the Deep Basin of Alberta, which happens to be one of the most active areas in the province. Activity is an off-spring of success in any given area and that is certainly the case here. An attraction to exploring in the Deep Basin is the potential for gas discoveries in multiple zones of the Cretaceous section, and the absence of water in these zones.
- We have drilled several good wells, a few exceptional wells, and we have had our share of disappointments, that is the model of an exploration company. We learn more with every well we drill and ***our production base is growing each year.***

In summation, Cinch's management remains very positive and we believe that with our substantial land base in the Deep Basin, and with the high level of industry activity and success surrounding our acreage, it's just a matter of time until we capitalize from this. Cinch is in an enviable position here and it is imperative that we drill more wells.

Cinch is "Positioned for Growth"!

John. W. Elick
Chairman and Chief Executive Officer
March 8, 2006

## PRESIDENT'S MESSAGE

In 2005, Cinch Energy Corp ("Cinch" or the "Company") pursued the ongoing exploration evaluation of its core lands in the Kakwa, Chime and Musreau areas, along with establishing another significant land position in Dawson West, British Columbia. The year was not without its challenges, as access to services in the drilling industry continued to be severely constrained, costs generally continued to escalate, and wet conditions in the field during the summer and warm weather in the winter delayed operations. Weather conditions have continued to affect operations, shortening the 2005 winter drilling season due to one of the warmest winters on record, in addition to access to drilling equipment continuing to be very tight.

The development of the 100% owned Kakwa H gas pool which was encouraging in 2004 had very mixed results in 2005. The first infill well drilled in 2005 at Kakwa 12-18 had very good results, as anticipated, however three subsequent development wells which encountered the Dunvegan sand had poor permeability and therefore low gas rates on completion. The 3-D seismic data has been very useful in identifying areas of sand development, however the data has its limitations with respect to predicting permeability. The Kakwa area has recently had some very good results in deeper horizons by operators offsetting the Company's lands. Cinch will be participating in a minimum of two deeper tests in 2006 to evaluate these deeper prospects.

Industry drilling activity in Cinch's core area and land sale prices continued to reach new highs, which supports your management's view that the area will provide substantial growth opportunities despite the challenges that occur over the life of an exploration program. During 2005, approximately 400 wells were spudded in your Company's core areas with some very impressive wells being completed and placed on production from various Cretaceous horizons. Management believes that its substantial land base in the Deep Basin will yield future drilling success as a number of high productivity wells have been drilled by industry offsetting your Company's land, which indicates that high productivity wells can be found in these areas. It is therefore imperative that Cinch continue to drill more wells on its land base.

### 2005 ACCOMPLISHMENTS

- received net proceeds of $19.1 million from the exercise of outstanding warrants
- completed a private placement in the third quarter raising net proceeds of $21.3 million
- increased annual production from 525 boe/d to 1,297 boe/d, an increase of 147%
- increased cash flow from $3.8 million to $15.0 million, an increase of 295%
- added a significant land position at Dawson West, British Columbia, consisting of 17,495 gross acres
- negotiated the acquisition of 3D seismic coverage in the East Chime area

## OUTLOOK

The outlook for Cinch's lands is promising as Cinch will continue to test new prospects in its core areas. These areas have witnessed a tremendous amount of drilling activity throughout the 2005 year leading to a new gas plant being built and an additional small gas plant being expanded to accommodate the new production growth. In addition, numerous operators have applied for permission for down-sized drilling spacing in the Musreau and Kakwa areas. These applications, along with continued drilling success, will lead to additional drilling on Cinch's land base. In the Musreau area alone, the Company has identified the possibility of 20 down-spaced locations for the future. With these down-spacing opportunities and multizone potential, your management compares the future potential in Cinch's core area to the currently very active Berland River, Leland, and Wild River areas to the southeast and the Redrock and Wapiti areas to the northwest, all within the Deep Basin trend.

Cinch exited the 2005 year in a very strong financial position with positive working capital of $3.5 million and an unused line of credit of $26.5 million. The Company has budgeted for approximately $44 million of capital expenditures in 2006, directed mainly at exploratory and development drilling to be funded from projected cash flow and existing lines of credit. Cinch has an excellent land and seismic base, therefore the majority of the funds are directed towards the drill bit. The Company also continues to evaluate acquisition opportunities which would provide growth and complement management's expertise.

Most recent trends in industry include a rising cost structure along with a decline in natural gas prices, the latter associated with the warm winter and the buildup in gas storage reserves. Overall, Cinch expects that prices will improve again over the intermediate term. The Company does not take a "quarter to quarter" approach in its exploration programs, rather we view our growth as a longer term process. In spite of the challenges that the Company faced in 2005, management remains very positive that its excellent land position in a very active area will provide future growth for the Company.

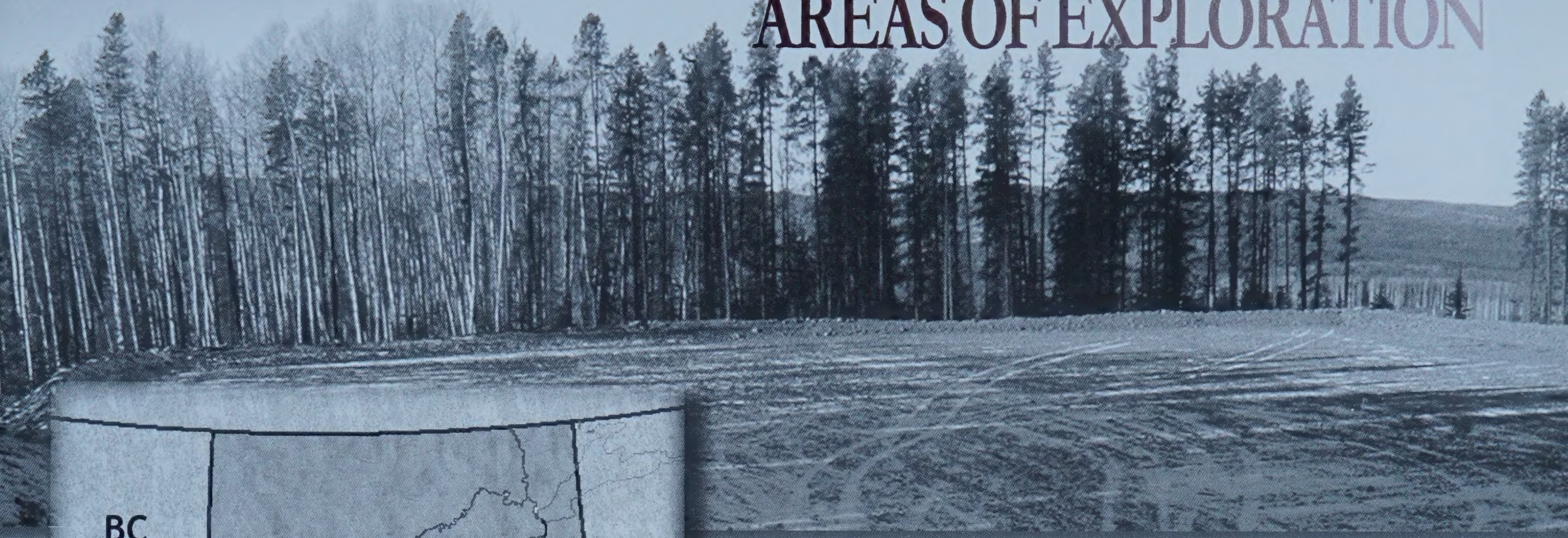
## ACKNOWLEDGEMENTS

On behalf of our executive team, I would like to thank all of the employees and the Directors for their valuable contribution throughout the year. In addition, I would like to express my appreciation to the shareholders for their continued faith in our exploration program which does take considerable time and perseverance in the Deep Basin.

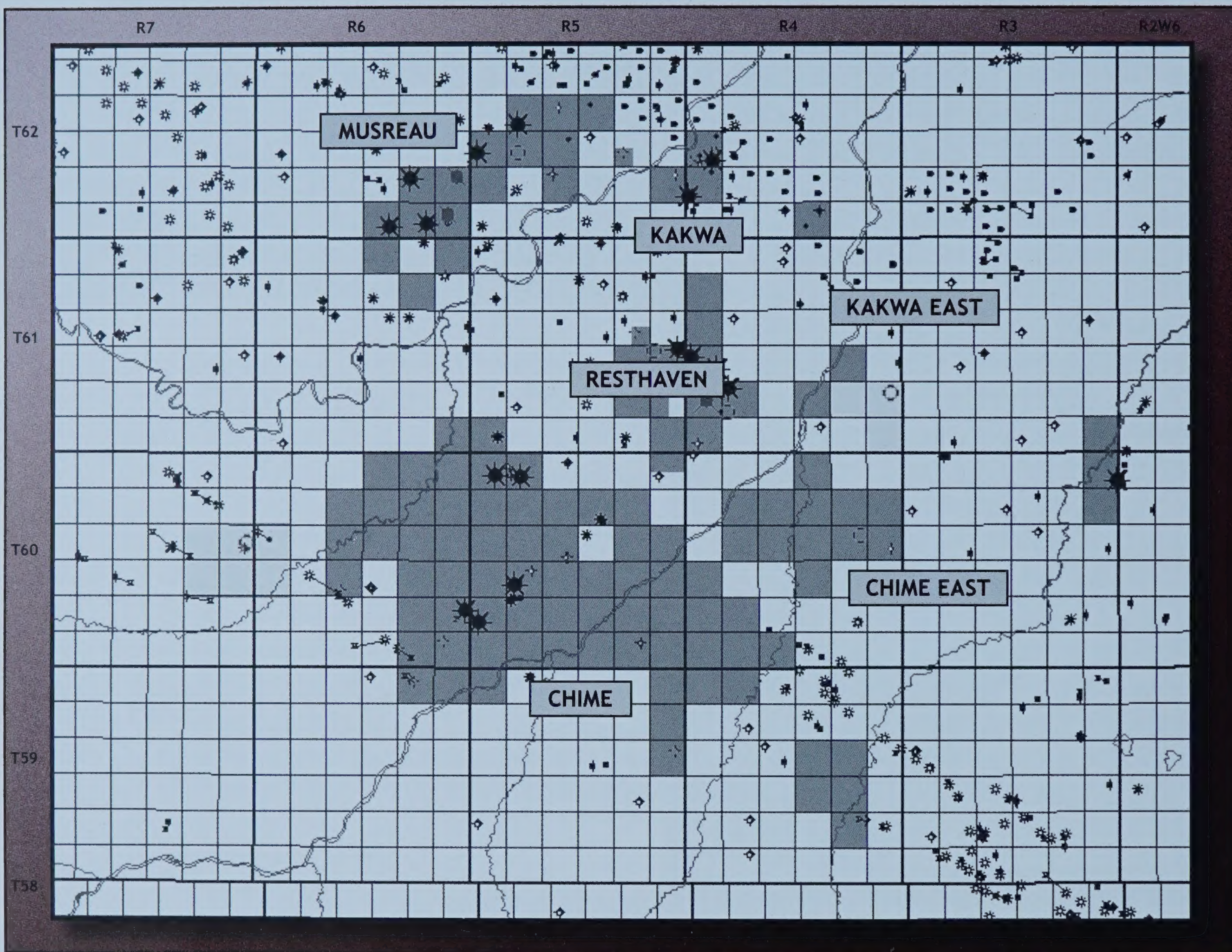
Finally, on behalf of the Board of Directors and notably from our Chairman and Chief Executive Officer, John W. Elick, we wish Clarence K. Wagenaar, who will not be submitting his name for reelection to the Board, best of luck and good health in the future, and thank him for his contributions to and support of Cinch's operations.

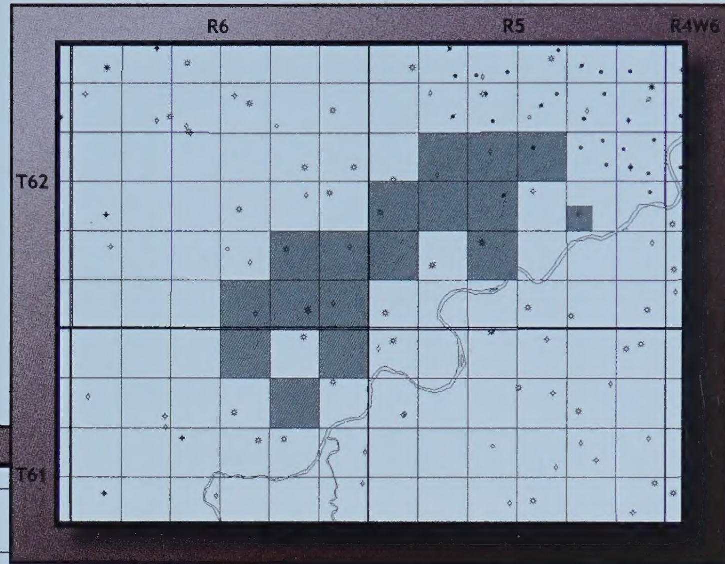
George Ongyerth
President
March 8, 2006

# AREAS OF EXPLORATION

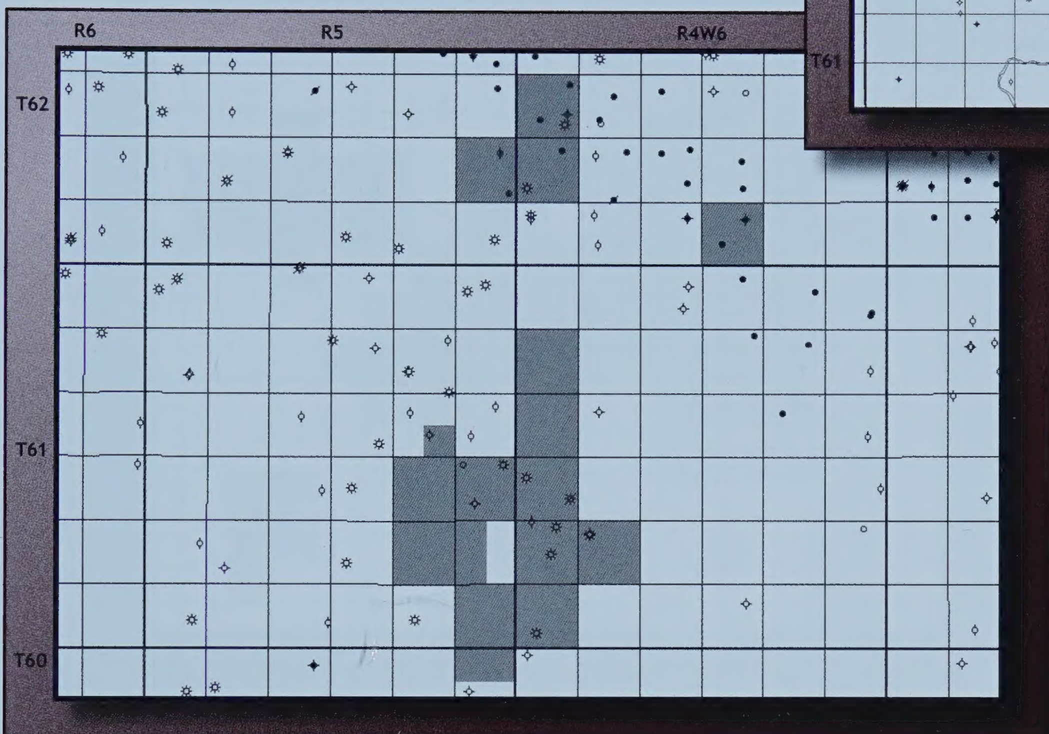



In 2005, Cinch pursued the ongoing exploration evaluation of its core lands in the Kakwa, Chime and Musreau areas, along with establishing a significant land position in Dawson West, British Columbia. The year was not without its challenges, as access to services in the drilling industry continued to be severely constrained, costs generally continued to escalate, and wet conditions during the summer and warm weather in the winter in the field delayed operations. Weather conditions have continued to affect operations, shortening the 2005 winter drilling season due to one of the warmest winters on record and access to drilling equipment continues to be very tight.


R7
R6
R5
R4
R3
R2W6
T62
T61
T60
T59
T58
MUSREAU
KAKWA
KAKWA EAST
RESTHAVEN
CHIME EAST
CHIME



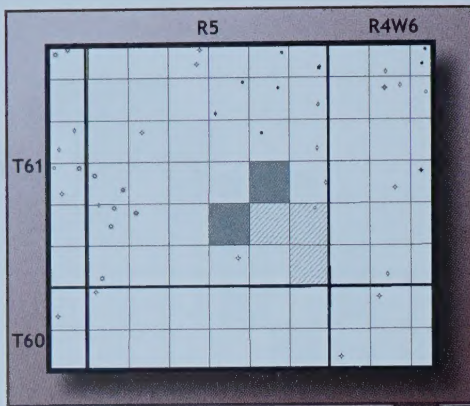

*Musreau*



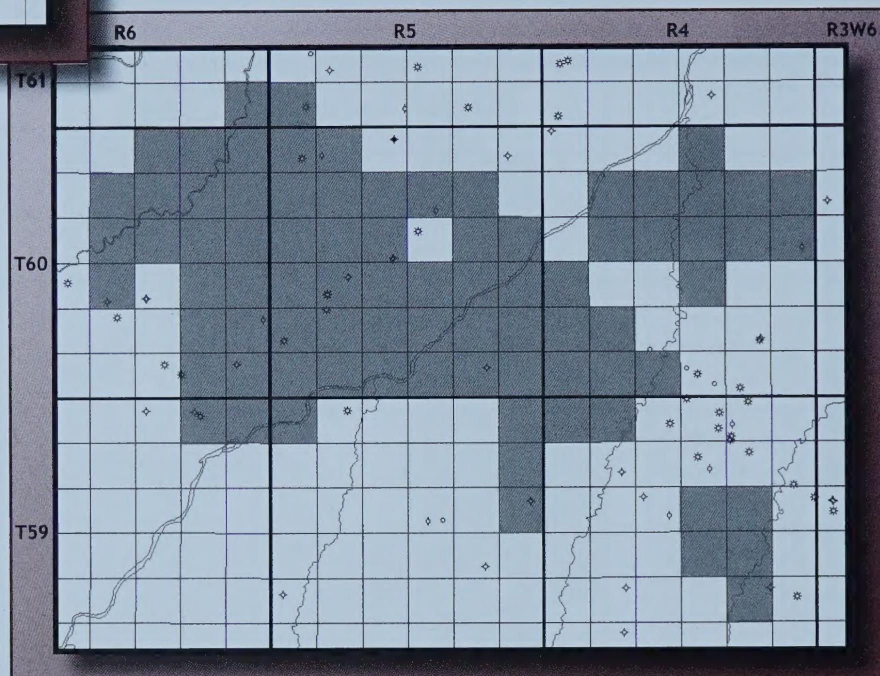

*Kakwa*

Four wells were drilled at **MUSREAU**, primarily focused on the Falher formation. All four were cased as potential gas wells, the most prolific being the 07-03-62-06W6 well, which has gas pay in four different zones. The productive zone encountered Falher B which AOF'd at 10 mmcf/d. This well has been tied in (as have the 05-18-62-05W6 and 03-20-62-05W6 gas wells) and is currently on production, although the 07-03 flow rate is constrained by facilities issues at this time. A fourth well at 06-17-62-05W6 was cased as a potential gas well after year end.

The Company drilled four wells in the **KAKWA** area in 2005. The 12-18-61-04W6 well encountered productive reservoir and has been tied-in and now produces at rates according to our model. This success, along with that of 16-13-61-04W6 late in the prior year, encouraged us to drill three step-out wells at high working interests. The Dunvegan sands were present in all three wells, however, permeabilities were lower than anticipated. Cinch has two additional Dunvegan development locations budgeted for later in 2006. Amendments to the current downspacing approvals have been filed with the AEUB for this area. In addition, this area has witnessed significant success by offsetting operators in deeper horizons. To date, Cinch has budgeted two wells in 2006 which will also test these deeper horizons.



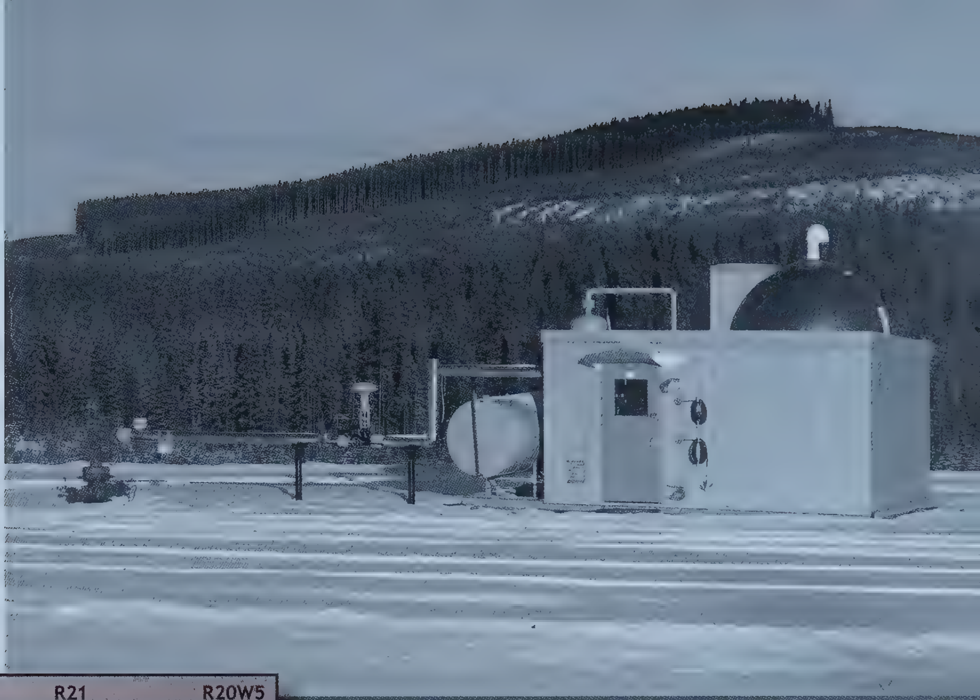

*Kakwa East*

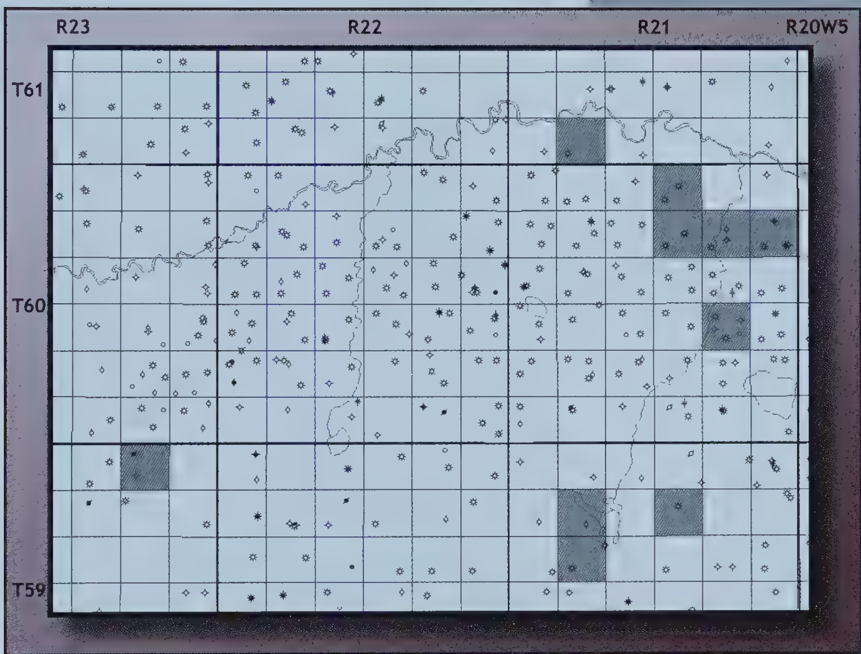



*Chime*

Cinch drilled four wells on the **CHIME** block, at an average working interest of 35.7 percent, with three of these wells being exploratory in nature. Two wells were drilled to evaluate all zones down to and including the Cadomin formation and both were cased, completed and tied-in as producing gas wells. Ultimate flow rates were less than expected, but valuable information into the subtleties shown on Cinch's 3-D seismic data set was collected which the Company hopes will result in a better success ratio in the future. A Cardium test was drilled at 02-27-60-05W6 and did not encounter the fault system which accounts for the prolifically productive Cardium trend to the southeast. A Dunvegan development well was drilled at 13-08-60-05W6 and is on production. The Company has budgeted two additional wells for 2006 in the Chime area.

Prospects have been mapped on the **CHIME EAST** and **KAKWA EAST** acreage and were scheduled to be drilled in 2005, however a combination of unfavorable weather conditions and an inability to obtain drilling rigs prevented them from being drilled in 2005. Cinch now expects to spud both the Chime East prospect in the summer and the Kakwa East prospect in the summer or during the 2006 winter drilling season.

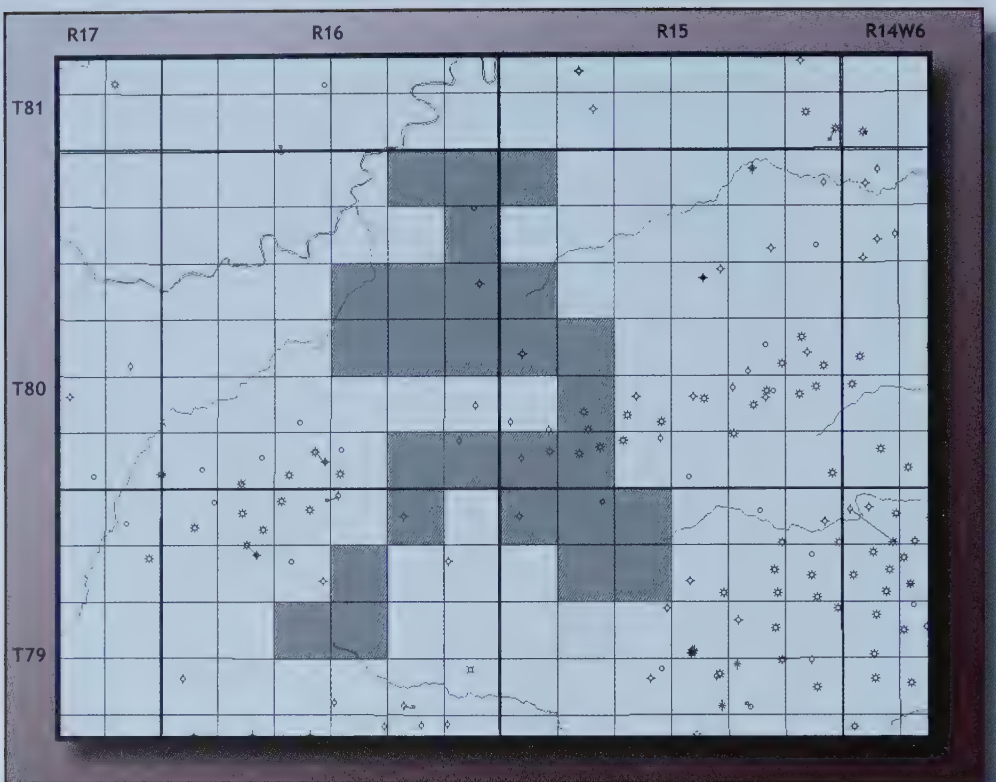





## *Bigstone*

One well was drilled at **BIGSTONE**. The well will be tied-in the first quarter of 2006.

The Company consummated a farmout arrangement at **RESTHAVEN** which saw a well drilled in the first quarter of 2006, at no cost to Cinch for drilling or completing the well. Cinch will have a 33.33% working interest in production. The well has been cased and is currently being completed. Results to date have been encouraging.




*Dawson West*

During 2005, Cinch joint ventured in the drilling of two wildcat exploration wells in the **DAWSON WEST** area in British Columbia. Participation in these wells earned Cinch an average 30% working interest in 27 sections of land. The Montney, Doig, Kiskatinaw and Notikewin formations are considered to be of primary attraction in the development of this new exploration area. One well was completed as a gas well, with additional seismic work and drilling being considered for the third quarter of 2006.

## Wells Drilled

| | December 31, 2005 | | December 31, 2004 | |
|---|---|---|---|---|
| | **Gross** | **Net** | Gross | Net |
| Natural gas | **14** | **6.4** | 6 | 2.8 |
| Oil | **0** | **0** | 0 | 0 |
| Dry and abandoned | **2** | **1.3** | 1 | 0.7 |
| Total | **16** | **7.7** | 7 | 3.2 |

## Undeveloped Land

Cinch's undeveloped land base of 108,307 gross acres (48,820 net acres) continues to represent a significant asset to the Company. Industry has paid record land prices during 2005 for undeveloped lands, particularly in the Deep Basin fairway, where Cinch operates. Prices at crown land sales in Cinch's core areas of Chime, Kakwa and Musreau averaged $2,400 per hectare ($960 per acre), with some lands directly offsetting Cinch's landholdings selling for as high as $6,100 per hectare ($2,440 per acre).

The Company has also developed a new exploration area in the Dawson West area of North East British Columbia, located approximately 10 kilometers north of Dawson Creek. Cinch holds an interest in 16,200 undeveloped gross acres (5,807 net acres) in this multi-zone area.

The Company has a high average net working interest of 45% in its undeveloped lands, the majority of which are operated by Cinch. This land position allows the Company to continue with an active exploration program without having to compete with industry at high priced land sales and to farmout a portion of our interest in the lands to manage risk, where desired.

## Undeveloped Land Holdings

| | **December 31, 2005** | December 31, 2004 |
|---|---|---|
| Gross Acres | **108,307** | 92,907 |
| Net Acres | **48,820** | 44,616 |
| Average Working Interest | **45%** | 48% |

## Reserves

The corporate reserves estimates, effective December 31, 2005, were prepared by the independent engineering firm of GLJ Petroleum Consultants Ltd. ("GLJ") in accordance with the definitions set out under National Instrument 5I-101 Standards of Disclosure for Oil and Gas Activities ("NI 51-101"). The reserve highlights are:

- Total proven reserves at December 31, 2005 increased 14% to 3.3 million boe compared to 2.9 million boe at December 31, 2004.
- Total proven plus probable reserves at December 31, 2005 increased 26% to 4.8 million boe compared to 3.8 million boe at December 31, 2004.
- On a proven plus probable basis, the finding, development and acquisition costs were $29.59 per boe ($43.63 per boe on a proven basis).
- On a proven plus probable basis, the finding and development costs were $34.71 per boe ($52.92 per boe on a proven basis).

## Forecasted Prices and Costs

**Summary of Oil and Gas Reserves - Gross Reserves(1)**

| | Light & Medium Crude Oil (mbbls) | Natural Gas Liquids (mmbls) | Natural Gas (mmcf) | Total 2005 (mboe) | Total 2004 (mboe) | Variance (2005 vs 2004) |
|---|---|---|---|---|---|---|
| Proved | | | | | | |
| - developed producing | 39 | 533 | 14,078 | 2,919 | 2,395 | 524 |
| - developed non-producing | 26 | 30 | 1,529 | 311 | 467 | (156) |
| - undeveloped | 2 | 2 | 268 | 49 | 0 | 49 |
| **Total Proved** | **67** | **565** | **15,875** | **3,279** | **2,862** | **417** |
| Probable | 28 | 258 | 7,223 | 1,490 | 927 | 563 |
| **Total Proved + Probable** | **96** | **823** | **23,097** | **4,768** | **3,789** | **979** |

*Note: May not add due to rounding*

(1) "Gross" means the total working interest (operating and non-operating) share before deduction of royalties payable to others and without including any royalty interest of Cinch.

### Net Present Value of Future Net Revenues Before Income Taxes(1)(2)(3)

| | Undiscounted | | | | Discounted at |
|---|---|---|---|---|---|
| December 31, 2005 | 0% ($M) | 8% ($M) | 10% ($M) | 15% ($M) | 20% ($M) |
| Proved | | | | | |
| - developed producing | 92,818 | 62,700 | 58,571 | 50,819 | 45,341 |
| - developed non-producing | 8,911 | 6,230 | 5,804 | 4,966 | 4,348 |
| - undeveloped | 368 | 62 | 6 | (111) | (202) |
| **Total Proved** | **102,097** | **68,992** | **64,381** | **55,674** | **49,487** |
| Probable | 44,776 | 17,668 | 15,326 | 11,498 | 9,154 |
| **Total Proved + Probable** | **146,873** | **86,661** | **79,706** | **67,171** | **58,641** |

*Note: May not add due to rounding*

(1) utilizing GLJ January 1, 2006 price forecast

(2) As required by NI 51-101, undiscounted well abandonment costs of $1.0 million for total proved reserves and $1.3 million for total proved plus probable reserves are included in the Net Present Value determination.

(3) prior to provision of income taxes, interest, debt service charges and general and administrative expenses; it should not be assumed that the undiscounted and discounted future net revenues estimated by GLJ represent the fair market value of the reserves

### Pricing Assumptions

The January 1, 2006 pricing forecasts presented below have been prepared by GLJ. These prices have been utilized in determining the reserves and cash flow forecasts above. Cinch Energy Corp. produces crude oil, natural gas and natural gas liquids.

| Year | Oil Edmonton Par Price 40° API ($CDN/bbl) | Natural Gas Alberta Plant Gate (Then Current) ($CDN/mmbtu) | Propane Edmonton ($CDN/bbl) | Butane Edmonton ($CDN/bbl) | Pentanes Plus Edmonton Light ($CDN/bbl) |
|---|---|---|---|---|---|
| 2006 | 66.25 | 10.35 | 42.50 | 49.00 | 67.00 |
| 2007 | 64.00 | 9.00 | 41.00 | 47.25 | 65.25 |
| 2008 | 59.25 | 7.75 | 38.00 | 43.75 | 60.50 |
| 2009 | 55.75 | 7.25 | 35.75 | 41.25 | 56.75 |
| 2010 | 54.00 | 6.95 | 34.50 | 40.00 | 55.00 |
| 2011 | 52.25 | 6.65 | 33.50 | 38.75 | 53.25 |
| 2012 | 52.25 | 6.65 | 33.50 | 38.75 | 53.25 |
| 2013 | 53.25 | 6.80 | 34.00 | 39.50 | 54.25 |
| 2014 | 54.25 | 6.95 | 34.75 | 40.25 | 55.25 |
| 2015 | 55.50 | 7.15 | 35.50 | 41.00 | 56.50 |
| 2016 | 56.50 | 7.30 | 36.25 | 41.75 | 57.75 |
| 2017+ | +2.0%/yr | +2.0%/yr | +2.0%/yr | +2.0%/yr | +2.0%/yr |

## Constant Prices and Costs

### Net Present Values of Future Net Reserves Before Income Taxes(1)(2)(3)

| December 31, 2005 | Undiscounted 0% ($M) | Discounted at 8% ($M) | 10% ($M) | 15% ($M) | 20% ($M) |
|---|---|---|---|---|---|
| Proved | | | | | |
| - developed producing | 117,145 | 75,470 | 69,789 | 59,199 | 51,815 |
| - developed non-producing | 11,735 | 7,819 | 7,214 | 6,040 | 5,189 |
| - undeveloped | 793 | 350 | 269 | 102 | (26) |
| **Total Proved** | **129,672** | **83,638** | **77,271** | **65,341** | **56,979** |
| Probable | 54,586 | 23,002 | 19,972 | 14,900 | 11,749 |
| **Total Proved + Probable** | **184,259** | **106,640** | **97,242** | **80,241** | **68,727** |

*Note: May not add due to rounding*

(1) Price assumptions: $68.27/bbl Cdn Edmonton Light Sweet Crude, $71.67/bbl Cdn. Edmonton Pentanes Plus and $9.46/mmbtu Cdn. Alberta Plant Gate - Spot "then current"

(2) As required by NI 51-101, undiscounted well abandonment costs of $0.72 million for total proved reserves and $0.80 million for total proved plus probable reserves are included in the Net Present Value determination.

(3) Prior to provision of income taxes, interest, debt service charges and general and administrative expenses. It should not be assumed that the undiscounted and discounted future net revenues estimated by GLJ represent the fair market value of the reserves.

## Reserve Reconciliation

### Reconciliation of Company Interest Reserves(1) by Principal Product Type - Forecast Prices and Costs

| | Crude Oil (mbbls) | | NGL's (mbbls) | | Natural Gas (mmcf) | | Equivalent (mboe) | |
|---|---|---|---|---|---|---|---|---|
| | Proved | Total Proved + Probable | Proved | Total Proved + Probable | Proved | Total Proved + Probable | Proved | Total Proved + Probable |
| December 31, 2004 | 0.0 | 0.0 | 535.4 | 691.8 | 13,982.0 | 18,606.5 | 2,865.7 | 3,792.8 |
| Technical | (0.9) | (0.9) | (23.9) | (18.3) | 182.0 | 198.3 | 5.5 | 13.8 |
| Exploration Discoveries | 0.0 | 0.0 | 0.4 | 0.5 | 68.2 | 91.0 | 11.7 | 15.6 |
| Drilling Extensions | 0.0 | 0.0 | 21.0 | 28.2 | 1,553.7 | 2,160.4 | 279.9 | 388.3 |
| Infill Drilling | 0.0 | 0.0 | 87.1 | 165.8 | 1,986.5 | 3,732.0 | 418.2 | 787.8 |
| Improved Recovery | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Acquisition | 68.4 | 96.5 | 25.0 | 34.7 | 563.7 | 768.5 | 187.4 | 259.3 |
| Production | 0.0 | 0.0 | (79.4) | (79.4) | (2,364.5) | (2,364.5) | (473.5) | (473.5) |
| **December 31, 2005** | **67.5** | **95.6** | **565.5** | **823.2** | **15,971.6** | **23,192.2** | **3,294.9** | **4,784.2** |

*Note: May not add due to rounding*

(1) Company interest reserves means the total working interest (operating and non-operating) share before deduction of royalties payable to others and including the Company's royalty interest in production or reserves.

**Reconciliation of Company Net Reserves[1] By Principal Product Type - Forecast Prices and Costs**

| | Light and Medium Oil | | | Associated and Non-Associated Gas | | | Natural Gas Liquids | | |
|---|---|---|---|---|---|---|---|---|---|
| **FACTORS** | Net Proved (mbbls) | Net Probable (mbbls) | Net Proved + Probable (mbbls) | Net Proved (mbbls) | Net Probable (mbbls) | Net Proved + Probable (mbbls) | Net Proved (mbbls) | Net Probable (mbbls) | Net Proved + Probable (mbbls) |
| December 31, 2004 | 0 | 0 | 0 | 10,024 | 3,343 | 13,367 | 331 | 101 | 432 |
| Extensions | 0 | 0 | 0 | 1,333 | 479 | 1,812 | 17 | 5 | 22 |
| Infill Drilling | 0 | 0 | 0 | 1,629 | 1,275 | 2,904 | 60 | 48 | 108 |
| Improved Recovery | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Technical Revisions | 0 | 0 | 0 | 305 | 11 | 316 | (2) | 2 | (1) |
| Discoveries | 0 | 0 | 0 | 55 | 18 | 73 | 0 | 0 | 0 |
| Acquisitions | 55 | 23 | 79 | 380 | 137 | 517 | 16 | 6 | 22 |
| Dispositions | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Economic Factors | 0 | 0 | 0 | (5) | (2) | (7) | (1) | 0 | (1) |
| Production | 0 | 0 | 0 | (1,703) | 0 | (1,703) | (55) | 0 | (55) |
| **December 31, 2005** | **55** | **23** | **79** | **12,019** | **5,262** | **17,281** | **367** | **162** | **529** |

*Note: May not add due to rounding*

(1) Net reserves means the Company's interest (operating and non-operating) share after deduction of royalty obligations, plus the Company's royalty interest in production or reserves.

Operations

## Finding and Development Costs (F&D) and Finding, Development and Net Acquisition Costs (FD&A)

NI 51-101 specifies how finding and development ("F&D") costs should be calculated if they are reported. Essentially NI 51-101 requires that the exploration and development costs incurred in the year along with the change in estimated future development costs be aggregated and then divided by the applicable reserve additions. The calculation specifically excludes the effects of acquisitions and dispositions on both reserve and costs. By excluding the effects of acquisitions and dispositions Cinch believes that the provisions of NI 51-101 do not fully reflect Cinch's ongoing reserve replacement costs. Since acquisitions can have a significant impact on Cinch's annual reserve replacement costs, to not include these amounts could result in an inaccurate portrayal of Cinch's cost structure. Accordingly, Cinch will also report finding, development and acquisition ("F,D&A") costs that will incorporate all acquisitions net of any dispositions during the year.

| | 2005 | | 2004 | | 3 year average | |
|---|---|---|---|---|---|---|
| | **Proved** | **Proved + Probable** | Proved | Proved + Probable | Proved | Proved + Probable |
| **Capital ($000's)** | | | | | | |
| Exploration and development | **36,045** | **36,045** | 16,050 | 16,050 | 20,945 | 20,945 |
| Acquisition capital | **1,515** | **1,515** | 49,645 | 49,645 | 17,145 | 17,145 |
| Change in future capital | **1,796** | **5,638** | 926 | 926 | 698 | 2,018 |
| Total capital including change in future capital | **39,356** | **43,198** | 66,621 | 66,621 | 38,788 | 40,108 |
| Total capital excluding goodwill | **39,356** | **43,198** | 52,005 | 52,005 | 33,916 | 35,236 |
| **Reserve additions (mboe)[1]** | | | | | | |
| Exploration and development | **715** | **1,201** | 1,270 | 1,503 | 689 | 820 |
| Acquisition | **187** | **259** | 1,342 | 1,810 | 512 | 693 |
| Total reserve additions (mboe) | **902** | **1,460** | 2,612 | 3,313 | 1,201 | 1,512 |
| **Costs ($/boe)** | | | | | | |
| F&D | **52.92** | **34.71** | 13.37 | 11.29 | 31.41 | 28.02 |
| FD&A | **43.63** | **29.59** | 25.51 | 20.11 | 32.30 | 26.52 |
| FD&A excluding goodwill | **43.63** | **29.59** | 19.91 | 15.70 | 28.24 | 23.30 |

*Note: May not add due to rounding*

(1) Company interest reserves, defined as the total working interest (operating and non-operating) share before deduction of royalties payable to others and including the Company's royalty interest in production or reserves.

## Net Asset Value

| ($ million, except per share) | Forecasted Prices 8% B.T. | Constant Prices 8% B.T. |
|---|---|---|
| Reserves, proven and probable[1] | 86.6 | 106.6 |
| Seismic data | 2.0 | 2.0 |
| Undeveloped land[2] | 23.4 | 23.4 |
| Working capital | 3.5 | 3.5 |
| Common shares outstanding, basic | 47.8 | 47.8 |
| Net asset value ($/share) | 2.42 | 2.84 |

The above table represents an internal calculation of the Net Asset Value per Company share at year end. The majority of the Company's land is located in the Deep Basin, where industry continues to pay premium prices as high as $2,440 per acre.

(1) Net present value of future net revenues before income taxes.
(2) In our calculation, we have used $480 per acre as the average land price for our undeveloped land (48,820 net acres).

### Production & Reserve Life Index

The Company's reserve life index using annualized fourth quarter production is 7.3 years for proven boe reserves compared to 8.0 years in 2004 and 10.5 years for proven plus probable boe reserves compared to 10.6 years in 2004.

Cinch exited the year at approximately 1,250 boe/d. A multi-well compressor was installed in one north Kakwa Field in December, 2004 to assist in maintaining production from the 04-07-62-04 W6M and 02-18-62-04 W6M wells and to minimize downtime due to fluctuations in line pressure and start-up of new wells into the main gathering system. This reduced the total downtime the Company was exposed to in 2005 as a result of these issues, although it did not completely eliminate them as high industry activity levels have placed pressure on infrastructure. This multi-well compressor will accommodate new production from the drilling associated with the approval of the holding application for the north Kakwa production.

| | 2005 | | 2004 | |
|---|---|---|---|---|
| Production calculated using: | **Annualized Q4** | **Average** | Annualized Q4 | Average |
| Production (boe/d) | **1,245** | **1,297** | 981 | 525 |
| Proved reserves (mboe)[1] | **3,295** | **3,295** | 2,866 | 2,866 |
| Proved reserve life index (years) | **7.3** | **7.0** | 8.0 | 15.0 |
| Proved plus probable reserves (mboe)[1] | **4,784** | **4,784** | 3,793 | 3,793 |
| Proved plus probable reserve life index (years) | **10.5** | **10.1** | 10.6 | 19.8 |

(1) Company interest reserves, defined as the total working interest (operating and non-operating) share before deduction of royalties payable to others and including the Company's royalty interest in production or reserves.

### Reserve Replacement

The Company's 2005 capital investment program replaced 2005 average production by a factor of 1.9 times on a proved basis and 3.1 times on a proved plus probable basis.

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | **Average** | **Annualized Q4** | Average | Annualized Q4 |
| Production (mboe) | **473.4** | **454.3** | 192 | 358 |
| Proved reserve additions after revisions of prior periods (mboe)[1] | **902** | **902** | 2,612 | 2,612 |
| Proven replacement ratio | **1.9** | **2** | 13.6 | 7.3 |
| Proved plus probable reserve additions after revision of prior periods (mboe) [1] | **1,460** | **1,460** | 3,313 | 3,313 |
| Proved plus probable replacement ratio | **3.1** | **3.2** | 17.3 | 9.3 |

(1) Company interest reserves, defined as the total working interest (operating and non-operating) share before deduction of royalties payable to others and including the Company's royalty interest in production or reserves.

### Recycle Ratio

The recycle ratio is a measure for evaluating the effectiveness of a company's re-investment program. The ratio measures the efficiency of capital investment. It accomplishes this by comparing the operating netback per barrel of oil equivalent to that year's reserve finding and development costs. Cinch Energy presents the recycle ratio on both an FD&A basis (based on 2005 actual FD&A) and an F&D basis.

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | **FD&A** | **F&D** | FD&A | F&D |
| Operating netbacks ($/boe) | **36.92** | **36.92** | 25.63 | 25.63 |
| Proved finding, development and net acquisition costs after revision of prior periods and including the change in future development capital ($/boe) | **43.63** | **52.92** | 25.51 | 13.37 |
| Proved recycle ratios | **0.9** | **0.7** | 1.0 | 1.9 |
| Proved plus probable finding, development and acquisition costs after revisions of prior periods and including the change in future development capital ($/boe) | **29.59** | **34.70** | 20.11 | 11.29 |
| Proved plus probable recycle ratios | **1.2** | **1.1** | 1.3 | 2.3 |

*Note: May not add due to rounding*

# MANAGEMENT'S DISCUSSION AND ANALYSIS

March 8, 2006

The following Management's Discussion and Analysis ("MD&A") should be read in conjunction with Cinch Energy Corp.'s ("Cinch" or the "Company") audited financial statements for the years ended December 31, 2005 and 2004. This commentary is based on the information available as at, and is dated, March 8, 2006. Additional information relating to Cinch, including Cinch's Annual Information Form when filed, is on SEDAR at www.sedar.com.

### *Forward Looking Statements*

Statements throughout this MD&A that are not historical facts may be considered to be "forward looking statements". These forward looking statements sometimes include words to the effect that management believes or expects a stated condition or result. All estimates and statements that describe the Company's objectives, goals, or future plans including management's assessment of future plans and operations, production estimates and expected production rates, timing of tie-ins and the effect of delays in tieing-in wells and the effects of third party compressor issues and other infrastructure issues, levels of decline rates and the effects thereof, expected royalty rates, general and administrative expenses and other expenses, effects of the results of successful wells, level of capital expenditures and the method of funding of capital expenditures, the ability to incur qualifying expenditures renounceable to purchasers of flow-through shares and the expected levels of activities and results of operations of the Company may constitute forward looking statements under applicable securities laws and necessarily involve risks including, without limitation, risks associated with oil and gas exploration, development, exploitation, production, marketing and transportation, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other producers, inability to retain drilling rigs and other services, incorrect assessment of the value of acquisitions, failure to realize the anticipated benefits of acquisitions, delays resulting from or inability to obtain required regulatory approvals and ability to access sufficient capital from internal and external sources. As a consequence, the Company's actual results may differ materially from those expressed in, or implied by, the forward looking statements. Readers are cautioned that the foregoing list of factors is not exhaustive. Additional information on these and other factors that could affect the Company's operations and financial results are included elsewhere herein and in reports on file with Canadian securities regulatory authorities and may be accessed through the SEDAR website (www.sedar.com), or at the Company's website (www.cinchenergy.com). Furthermore, the forward looking statements contained in this MD&A are made as at the date of this MD&A and the Company does not undertake any obligation to update publicly or to revise any of the included forward looking statements, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.

### *Non-GAAP Measures*

The MD&A contains the term "funds from operations" which should not be considered an alternative to, or more meaningful than, cash provided by operating activities or net income (loss) as determined in accordance with Canadian generally accepted accounting principles ("GAAP") as an indicator of the Company's performance. The Company's determination of funds from operations may not be comparable to that reported by other companies. The reconciliation between net income and funds from operations can be found in the Statements of Cash Flows included in the financial statements. The Company also presents funds from operations per share, where funds from operations is divided by the weighted average number of shares outstanding to determine per share amounts. The Company evaluates its performance based on earnings and funds from operations. The Company considers funds from operations to be a key measure that demonstrates ability to generate funds for future growth through capital investment.

### *Barrel of Oil Equivalency*

Natural gas reserves and volumes contained herein are converted to barrels of oil equivalent (boe) on the basis of six thousand cubic feet (mcf) of gas to one barrel (bbl) of oil. The term "barrels of oil equivalent" may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf to 1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

### *Growth Strategy*

Cinch Energy Corp. focuses on drilling as a means for achieving growth, and management believes that this is a viable and ultimately cost effective strategy. Management also believes that strategic acquisitions can and should play a part in our growth, where such acquisitions fit with and/or complement our own assets, or where they provide a balance to our existing program.

Throughout 2005, the Company focused on its programs in the Chime, Kakwa, Musreau and Bigstone areas, as well as the Peace River Arch area of British Columbia, by drilling and tieing-in production.

Growth cannot be achieved without the right people, and Cinch has assembled a management team comprised of experienced and knowledgeable individuals, very familiar with the Deep Basin.

## SALES

| | Three Months Ended December 31 | | | Year Ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2005** | 2004 | Change | **2005** | 2004 | Change |
| ***Sales volumes*** | | | % | | | % |
| Natural gas (mcf/d) | **6,248** | 4,953 | 26 | **6,478** | 2,707 | 139 |
| Liquids (bbl/d) | **203** | 155 | 31 | **217** | 73 | 197 |
| Equivalence (boe/d) | **1,245** | 981 | 27 | **1,297** | 525 | 147 |
| ***Sales prices*** | **$** | $ | % | **$** | $ | % |
| Natural gas | **12.44** | 7.29 | 71 | **9.59** | 6.97 | 38 |
| Liquids | **62.69** | 49.66 | 26 | **59.83** | 48.68 | 23 |
| Equivalence | **72.68** | 44.70 | 63 | **57.90** | 42.79 | 35 |

### Volumes

Sales volumes for the three months ended December 31, 2005 increased 27% over the comparable period in 2004 as a result of successful drilling results, with 13 new wells (7 net) commencing production in the year, four (2 net) of those coming on production in the fourth quarter.

Sales volumes in the fourth quarter of 2005 are fairly flat compared to the third quarter of 2005, as production additions were offset by natural declines. In the fourth quarter of 2005, the Company experienced tie-in delays and ongoing third party compressor issues in the Chime/Musreau/Kakwa areas. The Company has been installing compression on its operated locations to alleviate compression problems, which has helped, however system-wide issues on infrastructure controlled by third parties continue to sporadically impact the Company although to a lesser extent than in the third quarter. The Chime/Kakwa/Musreau areas have become much more active over the past two years, increasing pressure on infrastructure, challenged further by tight industry service conditions. However, the high activity levels have also increased third party interest in building facilities and infrastructure and this is expected to alleviate these issues over time.

Sales volumes for the year ended December 31, 2005 increased 147% over the comparable period in 2004 as a result of production additions in 2005 and the acquisition of the Canadian assets of Rio Alto Resources International Inc. ("Rio Alto") on August 12, 2004.

The Company's production is primarily from deep, tight gas, which will experience fairly high decline rates in the first two years, with decline rates typically reducing and stabilizing thereafter. As the Company builds a larger base of production, reflected in higher average production rates, declines on new production should have a less significant impact and a higher portion of capital should be spent on production growth versus replacing declines. Although the production base for the Company has improved in 2005 over 2004, reflected by average production of 1,297 boe/d versus 525 boe/d in 2004, management had forecast higher production averages. Several items, however, impacted the results, including the payout of two significant wells earlier than anticipated as a result of continued high gas prices (resulting in a reduction of approximately 77 boe/d for the year as well as the elimination of gross overriding royalties for these wells), delays as a result of warm weather and soft field conditions, difficulties in accessing services and a lack of availability of rigs, and lower than anticipated results on higher working interest wells in the Kakwa pool. The Company currently has two locations planned for Kakwa in 2006, at a lower working interest to mitigate risk.

Cinch exited the year with production of approximately 1,250 boe/d.

The Company has a number of locations planned for drilling in 2006. We do anticipate that some of the challenges incurred in 2005 will continue into 2006, however, we do not anticipate that all locations to be drilled in 2006 will be affected. The Company continues to work on strategies where possible to reduce the impact of lack of availability of rigs, delays in government approvals, and warm weather which impacts location access.

Natural gas prices remained strong throughout 2005, particularly in the second half of the year, and have significantly increased when compared to the same periods of 2004. It is anticipated that prices in the first quarter of 2006 will be lower than the last quarter of 2005. The Company's production continues to be unhedged and is marketed in the Alberta spot market.

Natural gas liquids pricing has also remained very strong and has also increased significantly when compared to the same periods of 2004. The Company has not hedged any of its liquids production.

## REVENUES

*Dollars in thousands, except per unit amounts*

| | Three Months Ended December 31 | | | Year Ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2005** | 2004 | Change | **2005** | 2004 | Change |
| | $ | $ | % | $ | $ | % |
| Oil and gas sales, net of transportation | 8,323 | 4,033 | 106 | 27,413 | 8,215 | 234 |
| Per boe | 72.68 | 44.70 | 63 | 57.90 | 42.79 | 35 |

Revenues for the three months and the year ended December 31, 2005 are higher than the same periods of 2004 due to increased production levels and increased commodity prices. Revenues during the fourth quarter of 2005 have increased by 15% compared to the third quarter of 2005, due to higher commodity prices. Transportation expenses as a percentage of revenues for the three months and year ended December 31, 2005 have remained consistent at approximately 3% when compared to the same periods of 2004, as expected.

## ROYALTIES

*Dollars in thousands, except per unit amounts*

| | Three Months Ended December 31 | | | Year Ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2005** | 2004 | Change | **2005** | 2004 | Change |
| | **$** | $ | % | **$** | $ | % |
| Royalties, net of ARTC | **2,109** | 1,211 | 74 | **7,213** | 2,205 | 227 |
| Per boe | **18.42** | 13.43 | 37 | **15.23** | 11.48 | 33 |

Royalty expense, net of Alberta Royalty Tax Credit, increased in the three months and year ended December 31, 2005 compared to the same periods of 2004 due to higher production levels and prices. The Company's royalty rate (royalties net of ARTC as a percentage of oil and gas sales) has remained consistent over the two years between 26% and 27%. The royalty rate for the first six months of 2006 is expected to be slightly lower after accounting for the benefits from the Alberta Royalty Tax Credit, increasing in the second half of the year once the maximum ARTC has been earned. The Company anticipates that its royalty rate in 2006 will be slightly lower than that of 2005.

## OTHER INCOME

*Dollars in thousands, except per unit amounts*

| | Three Months Ended December 31 | | | Year Ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2005** | 2004 | Change | **2005** | 2004 | Change |
| | **$** | $ | % | **$** | $ | % |
| Other income | **99** | 5 | 1,880 | **156** | 145 | 8 |
| Per boe | **0.87** | 0.06 | 1,350 | **0.33** | 0.76 | (57) |

Other income is comprised of interest income and gross overriding royalty revenue earned in 2005. The increase in other income in the three months and year ended December 31, 2005 compared to the same periods in 2004 is due to royalty revenue ($45 thousand) earned in 2005 which was not earned in 2004 and interest income ($111 thousand) earned on proceeds received from the September, 2005 private placement. In 2004, interest income was earned primarily on subscription receipt proceeds raised in a private placement in order to acquire Rio Alto's Canadian assets in August, 2004. These funds had been fully expended by the end of the third quarter of 2004. The Company anticipates that it will earn interest income in the first quarter of 2006 but that it will commence drawing on its credit facilities in the second quarter of 2006, thereby incurring interest expense.

## OPERATING EXPENSES

*Dollars in thousands, except per unit amounts*

| | Three Months Ended December 31 | | | Year Ended December 31 | | |
|---|---|---|---|---|---|---|
| | 2005 | 2004 | Change | 2005 | 2004 | Change |
| | $ | $ | % | $ | $ | % |
| Operating | 633 | 462 | 37 | 2,722 | 1,090 | 150 |
| Per boe | 5.53 | 5.12 | 8 | 5.75 | 5.68 | 1 |

Total operating expenses increased in the three months and year ended December 31, 2005 compared to the same periods in 2004 primarily as a result of higher production levels. Operating expenses per boe in the fourth quarter of 2005 are lower than for the full year of 2005 as additional operating expenses were incurred in the second and third quarters of 2005 on plant turnarounds, repairs and maintenance, freight and hauling, and wireline costs.

For the year ended December 31, 2005, operating expenses on a boe basis are only slightly higher than 2004. There is no single factor which identifies the slight increase other than additional expenditures incurred in the second and third quarters of 2005 as noted above, offset by efficiencies achieved from higher production levels.

Operating expenses are not expected to exceed $6.50 per boe in 2006.

## GENERAL AND ADMINISTRATIVE EXPENSES

*Dollars in thousands, except per unit amounts*

| | Three Months Ended December 31 | | | Year Ended December 31 | | |
|---|---|---|---|---|---|---|
| | 2005 | 2004 | Change | 2005 | 2004 | Change |
| | $ | $ | % | $ | $ | % |
| General and administrative | 912 | 490 | 86 | 2,749 | 1,463 | 88 |
| Per boe | 7.96 | 5.43 | 47 | 5.81 | 7.62 | (24) |

Total general and administrative costs have increased for the three months and year ended December 31, 2005 compared to the same periods of 2004 as a result of increased activity in 2005. The Company hired four additional employees, and increased compensation for existing staff in order to be more competitive in the marketplace, resulting in compensation and consulting fees increasing approximately 67% from $1.2 million in 2004 to $2.0 million in 2005. In addition, stock based compensation expense increased by $299 thousand due to options granted to new employees and additional options issued to existing employees in 2005. As at March 8, 2006, the Company has 2,453,000 options outstanding amounting to approximately 5% of issued shares and special warrants. Public company-related expenses such as audit fees, legal fees, stock exchange fees, press release and printing fees also increased from $105 thousand to $290 thousand, and office rent increased $100 thousand due to larger office premises obtained necessary to accomodate increased staff levels.

For the year ended December 31, 2005, general and administrative expenses per boe have decreased compared to 2004 due to increased production levels in 2005. General and administrative costs per boe have increased for the three months ended December 31, 2005 compared to the same period in 2004 due to increased employment costs in 2005.

General and administrative costs are not expected to exceed $5.25 per boe in 2006.

## INTEREST EXPENSE

*Dollars in thousands, except per unit amounts*

| | Three Months Ended December 31 | | | Year Ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2005** | 2004 | Change | **2005** | 2004 | Change |
| | $ | $ | % | $ | $ | % |
| Interest expense | **6** | 74 | (92) | **299** | 87 | 244 |
| Per boe | **0.05** | 0.82 | (94) | **0.63** | 0.46 | 37 |

Interest expense increased for the year ended December 31, 2005 compared to 2004 due to increased draws on the credit facility primarily in the first eight months of 2005. The Company completed a private placement in September, 2005 for gross proceeds of $22.5 million and eliminated its debt, thereby reducing its interest expense in the three months ended December 31, 2005. For the three months ended December 31, 2004, the Company had been drawn on its credit facility, thereby incurring interest expense.

The Company exited the year with positive net working capital and expects to draw on its $26.5 million credit facility in approximately the second quarter of 2006 to fund its capital program.

## ACCRETION OF ASSET RETIREMENT OBLIGATIONS EXPENSE

*Dollars in thousands, except per unit amounts*

| | Three Months Ended December 31 | | | Year Ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2005** | 2004 | Change | **2005** | 2004 | Change |
| | $ | $ | % | $ | $ | % |
| Accretion expense | **45** | 36 | 25 | **158** | 81 | 95 |
| Per boe | **0.40** | 0.39 | 3 | **0.33** | 0.42 | (21) |

Accretion expense increased for both the three months and year ended December 31, 2005 as a result of new locations drilled and gathering systems built for which an asset retirement obligation will be incurred, and as a result of asset retirement obligations acquired on the purchase of an interest in 10 wells in December 2005, resulting in a net increase of $254 thousand to the asset retirement obligation.

## DEPLETION AND DEPRECIATION EXPENSE

*Dollars in thousands, except per unit amounts*

| | Three Months Ended December 31 | | | Year Ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2005** | 2004 | Change | **2005** | 2004 | Change |
| | **$** | $ | % | **$** | $ | % |
| Depletion and depreciation | **2,697** | 1,434 | 88 | **9,257** | 3,128 | 196 |
| Per boe | **23.55** | 15.89 | 48 | **19.55** | 16.29 | 20 |

Depletion and depreciation expense increased for the three months and year ended December 31, 2005 compared to the same periods of 2004 as the Company has a larger capital base being depleted and higher production levels.

Depletion per boe has increased from the prior year due to a larger capital base being depleted, partially offset by net proven reserve additions of 5.4 bcf for the year ended December 31, 2005 and 2.8 bcf for the three months ended December 31, 2005.

## TAXES

*Dollars in thousands, except per unit amounts*

| | Three Months Ended December 31 | | | Year Ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2005** | 2004 | Change | **2005** | 2004 | Change |
| | **$** | $ | % | **$** | $ | % |
| Current | **18** | (4) | (550) | **98** | 13 | 654 |
| Future income taxes | **637** | 148 | 330 | **1,710** | 193 | 786 |
| Per boe | **5.72** | 1.59 | 260 | **3.82** | 1.08 | 254 |

Current taxes in the three months and year ended December 31, 2005 and 2004 is comprised of Large Corporations Tax (LCT), which increased over the prior year due to increased share capital, primarily as a result of warrants exercised in the first half of the year for gross proceeds of approximately $19.1 million and gross proceeds of approximately $22.5 million (2004 - $50.6 million) received from a private placement in September, 2005. The Company was not liable for LCT for the first seven months of 2004 as it had a lower capital base and became liable for LCT only after the Rio Alto acquisition in August, 2004.

Future income taxes in the three months and year ended December 31, 2005 arose as the Company earned income which was offset for tax purposes by drawing down its tax pools. The Company had tax pools of $57.2 million outstanding at December 31, 2005 (December 31, 2004 - $37.5 million).

## NET INCOME AND FUNDS FROM OPERATIONS

*Dollars in thousands, except per share figures*

| | Three Months Ended December 31 | | | Year Ended December 31 | | |
|---|---|---|---|---|---|---|
| | **2005** | 2004 | Change | **2005** | 2004 | Change |
| | **$** | $ | % | **$** | $ | % |
| Net income | **1,364** | 189 | 622 | **3,364** | 99 | 3,298 |
| - per basic share | **0.03** | 0.01 | 200 | **0.08** | 0.00 | 1,597 |
| - per diluted share | **0.03** | 0.01 | 200 | **0.08** | 0.00 | 1,684 |
| Funds from operations | **4,899** | 1,924 | 155 | **15,042** | 3,757 | 300 |
| - per basic share | **0.10** | 0.06 | 67 | **0.38** | 0.19 | 103 |
| - per diluted share | **0.10** | 0.05 | 100 | **0.36** | 0.17 | 112 |
| Weighted average shares & special warrants outstanding | **47,812,632** | 33,331,193 | 43 | **40,046,588** | 20,054,494 | 100 |

Net income increased for the three months and year ended December 31, 2005 when compared to the same periods of 2004 due to higher production levels and higher sales prices.

Funds from operations for the three months and year ended December 31, 2005 have significantly increased compared to the same periods of 2004 as a result of higher production, attributable to drilling results and the acquisition of the Rio Alto assets in August 2004, and as a result of higher commodity prices. Net income and funds from operations were also higher in the fourth quarter of 2005 compared to prior quarters of 2005 due to higher commodity prices.

## LIQUIDITY AND CAPITAL RESOURCES

*Dollars in thousands*

| | As at December 31 | | |
|---|---|---|---|
| | **2005** | 2004 | Change |
| | **$** | $ | % |
| Working capital (deficiency) | **3,490** | (4,795) | 173 |
| Credit facility | **-** | (9,964) | 100 |
| Net working capital (deficiency) | **3,490** | (14,759) | 124 |
| Capital lease obligation | **421** | 621 | (32) |
| Shareholders' equity | **93,400** | 48,335 | 93 |

Shareholder's equity and net working capital have increased in 2005 compared to 2004 due to equity issued during the year. Warrants exercised in the first half of the year provided gross proceeds of $19.1 million to the Company in exchange for 8,022,529 common shares issued. The Company also completed a private placement in September providing gross proceeds of $22.5 million in exchange for 6,029,413 common shares issued. The proceeds received from the September 2005 financing were used to fund capital spending for the fourth quarter and to completely pay down the credit facility. The Company exited the year with positive net working capital.

Looking forward, the Company anticipates funding its capital program with a combination of funds generated from operations and its $26.5 million credit facility.

## CAPITAL EXPENDITURES

### Additions to property, plant and equipment

*Dollars in thousands*

| | Year Ended December 31 | |
|---|---|---|
| | **2005** | 2004 |
| Land and rentals | **4,083** | 133 |
| Seismic | **796** | 842 |
| Drilling, completing and equipping | **26,046** | 12,695 |
| Pipelines and facilities | **5,038** | 2,310 |
| Other assets | **82** | 69 |
| Total | **36,045** | 16,049 |

Capital expenditures for the year ended December 31, 2005, were incurred primarily on drilling, completing and tieing-in locations in the Chime, Kakwa, Musreau, Bigstone areas and the Peace River Arch area of British Columbia.

Management's primary strategy is to expend capital on exploration and development drilling and to earn land by drilling. The Company may, however, also purchase land where considered strategic.

In December 2005, the Company expended $4 million at a public property auction acquiring a 25% working interest in 10 wells (three producing at December 31, 2005) and 7.25 sections (gross) of land in the Kakwa area. In 2005, the Company also purchased an additional 2.25 sections (net) in the Kakwa area, an increasingly competitive area. The Company also purchased land in the Dawson West area, a new area for the Company, acquiring working interests between 20% and 40% in 18 sections of land. The Company subsequently earned the rights to an additional nine sections (gross) of land in Dawson West by drilling two wells. The Company is performing additional geological and geophysical appraisals with the anticipation that another well will be drilled on these lands during the second or third quarter of 2006. Successful results would help in establishing another core area for the Company.

### Tax pools at December 31, 2005:

*Dollars in thousands*

| | **2005** | 2004 |
|---|---|---|
| COGPE | **7,620** | 4,172 |
| CDE | **18,412** | 13,041 |
| CEE | **15,723** | 11,287 |
| Tangibles | **15,488** | 9,049 |
| | **57,243** | 37,549 |

The Company's tax pools increased significantly in 2005 as a result of capital expenditures which were higher than the amount needed to eliminate taxable income. The equity financing completed in September 2005 included flow through common shares of $10 million. As at December 31, 2005, $2.6 million of the required expenditures had been incurred and the full $10 million was renounced in February 2006. The Company anticipates no difficulties incurring the remaining $7.4 million expenditures in 2006. A future tax liability will be recorded in the first quarter of 2006 to reflect the renouncement.

## BUSINESS RISKS AND RISK MANAGEMENT

The long-term commercial success of the Company depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. Cinch attempts to reduce risk in accomplishing these goals through the combination of hiring experienced and knowledgeable personnel and careful evaluation.

The Company's program is exploratory in nature and in areas with deep, tight gas. The wells the Company drills therefore tend to be deep (a substantial portion are deeper than 2,500 meters), and are subject to higher drilling costs than those in more shallow areas. In addition, most wells require fracture treatment before they are capable of production, also increasing costs. The Company mitigates the additional economic pressure that this creates by carefully evaluating risk/reward scenarios for each location, by practicing prudent operations so that drilling risk is decreased, by ranking and limiting the zones that the Company is willing to complete, and also by drilling deep so that the multi-zone potential of the area can be accessed and potentially developed. The Company operates the majority of its lands which provides a measure of control over the timing and location of capital expenditures. In addition, the Company monitors capital spending on an ongoing and regular basis so that the Company maintains liquidity and so that future financial resource requirements can be anticipated.

Commodity price fluctuations can pose a risk to the Company, and management monitors these on an ongoing basis. External factors beyond the Company's control may affect the marketability of the natural gas and natural gas liquids produced. The Company has not to date implemented any hedging instruments.
The Company has selected the appropriate personnel to monitor operations and has automated field information where possible, so that difficulties and operational issues can be assessed and dealt with on a timely basis, and so that production can be maximized as much as possible.

Oil and natural gas exploration, development and production operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blowouts, and spills, each of which could result in damage to wells, production facilities, other property and the environment or in personal injury. In accordance with industry practice, the Company insures against most of these risks (although not all such risks are insurable). The Company maintains liability insurance in an amount that it considers consistent with industry practice, although the nature of these risks is such that liabilities could potentially exceed policy limits. The Company also reduces risk by operating a large percentage of its operations. As such, the Company has control over the quality of work performed and the personnel involved.

The Company anticipates making substantial capital expenditures in future for the exploration, development, acquisition and production of oil and natural gas reserves. If the Company's revenues or reserves decline, it may have limited ability to expend the capital necessary to undertake or complete future drilling programs. There can be no assurance that debt or equity financing will be available. The Company mitigates this risk by monitoring expenditures, operations and results of operations in order to manage available capital effectively.

Attracting and retaining qualified individuals is crucial to the Company's success. The Company understands the importance of maintaining competitive compensation levels given this increasingly competitive environment in which the Company operates. The inability to attract and retain key employees could have a material adverse effect on the Company.

## DISCLOSURE CONTROLS AND PROCEDURES

The Company has established disclosure controls and procedures to provide reasonable assurance that material information required to be disclosed is recorded, processed, summarized and reported within the time periods specified by securities regulations and that information required to be disclosed is communicated to management on a timely basis. The Chief Executive Officer and the Chief Financial Officer have evaluated the effectiveness of these controls and procedures and have concluded that they are adequate and effective as at the end of the period covered by this management discussion and analysis, in all material respects.

## SEASONALITY OF OPERATIONS

The Company's ability to move heavy equipment in the oil and natural gas fields is dependent on weather conditions. Rain and snow can impact conditions, and many secondary roads and future oil and gas production sites are incapable of supporting the weight of heavy equipment until the roads are thoroughly dried out. The duration of difficult conditions has a direct impact on the Company's activity levels and as a result can delay operations.

## FUTURE PROSPECTS

Management continues to be optimistic about the growth of the Company, despite the challenges encountered in 2005. Cinch has assembled a large, contiguous block of land which is still relatively unexplored and has entered into a new play in British Columbia. The Company has a strong balance sheet and with prudent risk management, careful evaluation of results, continued development of the lands as well as expansion into new areas, management believes that the Company will continue to grow and that success will continue to be achieved.

## CONTRACTUAL OBLIGATIONS, COMMITMENTS, AND GUARANTEES

The Company has assumed various contractual obligations and commitments in the normal course of its operating and financing activities. These obligations and commitments have been considered when assessing the Company's cash requirements in its analysis of future liquidity.

*Dollars in thousands*

| | | | Payments | | |
|---|---|---|---|---|---|
| | **Total** | < 1 year | 1-3 years | 4-5 years | > 5 years |
| | $ | $ | $ | $ | $ |
| Capital lease obligation | **631** | 210 | 421 | – | – |
| Operating lease | **672** | 163 | 509 | – | – |
| Asset retirement obligations | **2,726** | 223 | 129 | – | 2,374 |
| | **4,029** | 596 | 1,059 | – | 2,374 |

## RECENT ACCOUNTING PRONOUNCEMENTS

The Canadian Institute of Chartered Accountants (CICA) has issued a number of accounting pronouncements, some of which may impact the Company's reported results and financial position in future periods.

### *Comprehensive Income, Financial Instruments and Hedges*

The CICA issued new accounting standards in early 2005 for Comprehensive Income (CICA 1530), Financial Instruments (CICA 3855) and Hedges (CICA 3865), which will be effective for the reporting year-end 2007 and will be applicable to all companies.

The new standards will bring Canadian rules in line with current rules in the US. The standards will introduce the concept of "Comprehensive Income" to Canadian GAAP and will require that an enterprise (a) classify items of comprehensive income by their nature in a financial statement and (b) display the accumulated balance of comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position. Derivative contracts will be carried on the balance sheet at their mark-to-market value, with the change in value flowing to either net income or comprehensive income. Gains and losses on instruments that are identified as hedges will flow initially to comprehensive income and be brought into net income at the time the underlying hedged item is settled. Any instruments that do not qualify for hedge accounting will be marked-to-market with the adjustment (tax effected) flowing through the income statement. The Company does not currently have any hedges in place so the impact would not be significant based on the current positions.

## CRITICAL ACCOUNTING ESTIMATES

There are a number of critical estimates underlying the accounting policies the Company applies in preparing its financial statements.

### *Reserves*

The estimate of reserves is used in forecasting what will ultimately be recoverable from the properties and their economic viability and in calculating the Company's depletion and potential impairment of asset carrying costs. The process of estimating reserves is complex and requires significant interpretation and judgment. It is affected by economic conditions, production, operating and development activities and is performed using available geological, geophysical, engineering and economic data.

Reserves at year end are evaluated by an independent engineering firm and quarterly updates to those reserves are estimated by the Company.

### *Revenue Estimates*

Payment and actual amounts for petroleum and natural gas sales can be received months after production. The Company estimates a portion of its petroleum and natural gas production, sales and related costs, based upon information received from field offices, internal calculations, historical and industry experience.

### *Cost Estimates*

Costs for services performed but not yet billed are estimated based on quotes provided and historical and industry experience.

### *Asset Retirement Obligations*

The liability recorded for asset retirement obligations, an estimate of restoring assets and locations back to environmental and regulatory standards upon future retirement or abandonment, include estimates of restoration costs to be incurred in the future and an estimated future inflation rate. Costs estimated are based upon internal and third party calculations and historical experience and future inflation rates are estimated using historical experience and available economic data.

### *Income taxes*

The Company records future tax liabilities to account for the expected future tax consequences of events that have been recorded in its financial statements. These amounts are estimates; the actual tax consequences may differ from the estimates due to changing tax rates and regimes, as well as changing estimates of cash flows and capital expenditures in current and future periods. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded.

## TREND ANALYSIS

Throughout 2005, the Company has been active in drilling and completing wells, as well as tieing-in production, generating both positive net income and increasing cash flows. The Company's asset base continues to grow with a total of $37.3 million spent on capital expenditures and acquisitions in 2005. The Company is still in the expansion phase of its program and anticipates future drilling to continue to delineate the plays on its lands. Throughout 2005, the Company has been faced with several challenges, causing drilling, completion and tie-in activities to be delayed toward the end of 2005 and pushed into 2006. The Company's business is affected by seasonal temperature changes. In 2005, the Company's core areas experienced unusually warm temperatures delaying activities toward the end of 2005 and into 2006. In the fourth quarter, the Company encountered further delays due to lack of rig availability, thereby pushing some planned drilling activity into the first, second and third quarters of 2006.

When comparing 2005 to 2004, revenues and funds from operations as well as net income have increased as a result of higher gas prices, higher production levels attributable to drilling results, acquisitions occurring in 2005 and a full year of production attributable to the wells acquired as part of the Rio Alto acquisition in August 2004. The increase in income and funds from operations have also led to increased earnings per share and increased cash flows per share when compared to 2004.

## SELECTED ANNUAL AND QUARTERLY INFORMATION

*(000's, except per share and production data)*

| | Q1 | Q2 | Q3 | Q4 | Annual |
|---|---|---|---|---|---|
| **2005** | $ | $ | $ | $ | $ |
| Petroleum and natural gas sales, net of transportation and before royalties | 6,062 | 5,821 | 7,207 | 8,323 | 27,413 |
| Funds from operations | 3,198 | 3,037 | 3,908 | 4,899 | 15,042 |
| Per share - basic | 0.10 | 0.09 | 0.09 | 0.10 | 0.38 |
| - diluted | 0.09 | 0.08 | 0.09 | 0.10 | 0.36 |
| Net income | 612 | 537 | 851 | 1,364 | 3,364 |
| Per share - basic | 0.02 | 0.01 | 0.02 | 0.03 | 0.08 |
| - diluted | 0.02 | 0.01 | 0.02 | 0.03 | 0.08 |
| Capital expenditures | 6,381 | 8,116 | 9,566 | 11,982 | 36,045 |
| Acquisition | — | — | 1,220 | (15) | 1,205 |
| Total assets | 80,706 | 89,047 | 112,178 | 113,620 | 113,620 |
| Net working capital (deficiency) | (16,621) | (3,670) | 10,629 | 3,490 | 3,490 |
| Production (boe/d) | 1,421 | 1,264 | 1,262 | 1,245 | 1,297 |
| **2004** | $ | $ | $ | $ | $ |
| Petroleum and natural gas sales, net of transportation and before royalties | 733 | 873 | 2,577 | 4,033 | 8,215 |
| Funds from operations | 190 | 329 | 1,314 | 1,924 | 3,757 |
| Per share - basic | 0.02 | 0.03 | 0.06 | 0.06 | 0.19 |
| - diluted | 0.02 | 0.03 | 0.06 | 0.05 | 0.17 |
| Net income (loss) | (231) | 11 | 131 | 189 | 99 |
| Per share - basic | (0.02) | (0.00) | 0.01 | 0.01 | 0.00 |
| - diluted | (0.02) | (0.00) | 0.01 | 0.01 | 0.00 |
| Capital expenditures | 1,726 | 1,492 | 1,446 | 11,385 | 16,049 |
| Acquisition | — | — | 48,625 | 79 | 48,704 |
| Total assets | 13,548 | 54,995 | 66,060 | 77,560 | 77,560 |
| Net working capital (deficiency) | 990 | 109 | (6,011) | (14,759) | (14,759) |
| Production (boe/d) | 204 | 216 | 691 | 981 | 525 |
| **2003** | $ | $ | $ | $ | $ |
| Petroleum and natural gas sales, net of transportation and before royalties | 813 | 482 | 343 | 274 | 1,912 |
| Funds from operations | 478 | 270 | 47 | (2) | 793 |
| Per share - basic | 0.07 | 0.04 | 0.01 | (0.00) | 0.09 |
| - diluted | 0.07 | 0.03 | 0.01 | (0.00) | 0.09 |
| Net-income (loss) | (60) | 191 | (107) | (4,197) | (4,173) |
| Per share - basic | (0.01) | 0.02 | (0.01) | (0.40) | (0.49) |
| - diluted | (0.01) | 0.02 | (0.01) | (0.40) | (0.49) |
| Capital expenditures | 1,530 | 3,394 | 2,808 | 3,395 | 11,128 |
| Total assets | 13,234 | 13,655 | 14,731 | 13,615 | 13,615 |
| Net working capital (deficiency) | 2,659 | (465) | 937 | 2,526 | 2,526 |
| Production (boe/d) | 182 | 126 | 98 | 85 | 124 |

*Per share amounts reflect a 2.5 for 1 common share consolidation which occurred on August 12, 2004.*
*Note: numbers may not cross-add due to rounding*

# AUDITORS' REPORT

To the Shareholders of
Cinch Energy Corp.

We have audited the balance sheets of Cinch Energy Corp. as at December 31, 2005 and 2004 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Chartered Accountants

Calgary, Canada
March 8, 2006

# CINCH ENERGY CORP.

*Balance Sheets*

| *As at December 31,* | 2005<br>$ | 2004<br>$ |
|---|---|---|
| ASSETS *[note 6]* | | |
| **Current** | | |
| Cash and cash equivalents *[note 3]* | **5,654,594** | — |
| Accounts receivable *[note 4]* | **6,510,076** | 5,359,644 |
| Prepaid expenses and deposits | **752,551** | 729,502 |
| | **12,917,221** | 6,089,146 |
| **Property, plant and equipment** *[note 5]* | **86,085,917** | 56,854,192 |
| **Goodwill** *[note 5]* | **14,616,996** | 14,616,996 |
| | **113,620,134** | 77,560,334 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| **Current** | | |
| Accounts payable and accrued liabilities | **9,216,805** | 10,677,651 |
| Credit facility *[note 6]* | **—** | 9,963,616 |
| Current portion of capital lease obligation *[note 7]* | **210,007** | 206,921 |
| | **9,426,812** | 20,848,188 |
| **Capital lease obligation** *[note 7]* | **420,988** | 620,764 |
| **Asset retirement obligations** *[note 8]* | **2,725,627** | 1,633,234 |
| **Future income tax liability** *[note 9]* | **7,646,760** | 6,123,388 |
| | **20,220,187** | 29,225,574 |
| **Commitments** *[note 11]* | | |
| **Shareholders' equity** | | |
| Share capital *[note 10]* | **93,044,644** | 51,840,767 |
| Contributed surplus *[note 10]* | **1,250,842** | 753,449 |
| Deficit | **(895,539)** | (4,259,456) |
| | **93,399,947** | 48,334,760 |
| | **113,620,134** | 77,560,334 |

*See accompanying notes*

On behalf of the Board:

John W Elick

Director

R D Robertson

Director

# CINCH ENERGY CORP.

*Statements of Operations and Deficit*

| *For the years ended December 31,* | 2005<br>$ | 2004<br>$ |
|---|---|---|
| **Revenue** | | |
| Oil and gas sales | 28,282,556 | 8,507,486 |
| Transportation | (869,753) | (292,773) |
| Royalties, net of Alberta Royalty Tax Credit | (7,212,766) | (2,205,060) |
| Other income | 155,697 | 145,083 |
| | 20,355,734 | 6,154,736 |
| **Expenses** | | |
| Operating | 2,721,887 | 1,089,768 |
| General and administrative *[note 10]* | 2,748,928 | 1,462,605 |
| Interest on credit facility *[note 6]* | 276,577 | 87,366 |
| Interest on capital lease *[note 7]* | 22,274 | — |
| Accretion of asset retirement obligations *[note 8]* | 157,849 | 81,149 |
| Depletion and depreciation | 9,256,752 | 3,127,970 |
| | 15,184,267 | 5,848,858 |
| **Income before taxes** | 5,171,467 | 305,878 |
| **Taxes** *[note 9]* | | |
| Current | 97,650 | 13,150 |
| Future income taxes | 1,709,900 | 193,486 |
| | 1,807,550 | 206,636 |
| **Net income for the year** | 3,363,917 | 99,242 |
| **Deficit, beginning of year** | (4,259,456) | (4,358,698) |
| **Deficit, end of year** | (895,539) | (4,259,456) |
| **Net income for the year per share** *[note 10]* | | |
| Basic and diluted | 0.08 | 0.00 |
| **Weighted average number of shares outstanding** *[note 10]* | | |
| Basic | 40,046,588 | 20,054,494 |
| Diluted | 41,921,643 | 22,068,795 |

*See accompanying notes*

# CINCH ENERGY CORP.

*Statements of Cash Flows*

| *For the years ended December 31,* | 2005 $ | 2004 $ |
|---|---|---|
| **Operating activities** | | |
| Net income for the year | 3,363,917 | 99,242 |
| Add non-cash items: | | |
| Depletion and depreciation | 9,256,752 | 3,127,970 |
| Accretion of asset retirement obligations | 157,849 | 81,149 |
| Non-cash compensation expense *[note 10]* | 553,866 | 254,705 |
| Future income taxes | 1,709,900 | 193,486 |
| **Funds from operations** | 15,042,284 | 3,756,552 |
| Net change in non-cash working capital | (722,225) | (1,467,607) |
| Cash provided by operating activities | 14,320,059 | 2,288,945 |
| **Investing activities** | | |
| Additions to property, plant and equipment | (36,045,324) | (16,049,479) |
| Proceeds from dispositions of property, plant and equipment | – | 560,000 |
| Acquisition, net of cash acquired *[note 5]* | (1,204,754) | (44,624,190) |
| Net change in non-cash working capital | (1,937,990) | 3,576,441 |
| Cash used by investing activities | (39,188,068) | (56,537,228) |
| **Financing activities** | | |
| Issue of common shares, net of issue costs | 40,723,117 | 2,509,839 |
| Increase (decrease) in credit facility | (9,963,616) | 9,963,616 |
| Issue of subscription receipts, net of issue costs | – | 37,304,676 |
| Proceeds from (payments on) capital lease | (196,690) | 827,685 |
| Net change in non-cash working capital | (40,208) | 30,319 |
| Cash provided by financing activities | 30,522,603 | 50,636,135 |
| **Increase (decrease) in cash** | 5,654,594 | (3,612,148) |
| **Cash and cash equivalents, beginning of year** | – | 3,612,148 |
| **Cash and cash equivalents, end of year** | 5,654,594 | – |
| **Supplemental information:** | | |
| Cash taxes paid | 89,858 | 3,775 |
| Cash interest paid | 298,851 | 74,865 |

*See accompanying notes*

## NOTES TO THE FINANCIAL STATEMENTS

# CINCH ENERGY CORP.

December 31, 2005 and 2004

### 1. DESCRIPTION OF BUSINESS

Cinch Energy Corp. (the "Company") was incorporated under the laws of the Province of Alberta and commenced operations on December 1, 2001. The Company's activities are comprised of the exploration for and development of oil and natural gas properties, primarily in Western Canada. On August 12, 2004, the Company acquired all of the issued and outstanding common shares of 1099017 Alberta Ltd. ("1099017") and amalgamated with 1099017 immediately thereafter, continuing as Cinch Energy Corp. On August 4, 2005, the Company acquired all of the issued and outstanding common shares of and wound up 1008742 Alberta Ltd. into Cinch Energy Corp.

### 2. SIGNIFICANT ACCOUNTING POLICIES

These financial statements, which have been prepared in accordance with Canadian generally accepted accounting principles, have in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

**Cash and cash equivalents**

Term deposits with initial maturities less than three months are considered to be cash equivalents and are recorded at cost, which approximates market value.

**Property, Plant and Equipment**

***Petroleum and natural gas properties***

The Company follows the full cost method of accounting for its petroleum and natural gas activities, whereby all costs associated with the exploration for and development of petroleum and natural gas reserves, whether productive or unproductive, are capitalized in a single Canadian cost center and charged to income as set out below. Such costs can include lease acquisition, drilling, geological and geophysical, and equipment costs, and overhead expenses directly related to exploration and development activities. Proceeds from disposal of properties will normally be applied as a reduction of the cost of the remaining assets, except when such a disposal would alter the depletion rate by more than 20 percent, in which case a gain or loss will be recorded.

***Ceiling test***

The net carrying value of the Company's petroleum and natural gas properties is limited to an ultimate recoverable amount. The Company tests impairment against undiscounted future net revenue from proved reserves using expected future prices and costs as well as the income tax and Alberta Royalty Tax Credit legislation in effect at the period end. Impairment is recognized when the carrying value of the assets is greater than the undiscounted future net revenues, in which case the assets are written down to the fair value of proved plus probable reserves plus the cost of unproved properties, net of impairment allowances. Fair value is determined based on discounted future net cash flows calculated using expected future prices and costs as well as the income tax legislation in effect at the period end. The discounted rate used is a risk free interest rate.

***Depletion***

Depletion of petroleum and natural gas properties and related production equipment is provided on accumulated costs using the unit of production method based on estimated proven petroleum and natural gas reserves, before royalties, as determined by independent engineers. For purposes of the depletion calculation, proven petroleum and natural gas reserves are converted to a common unit of measure on the basis that six thousand cubic feet of natural gas is equivalent to one barrel of petroleum.

The depletion cost base includes total capitalized costs, less costs of unproven properties, plus for the estimated future development costs associated with proven undeveloped reserves.

The carrying value of undeveloped properties is reviewed periodically. The excess of carrying value of undeveloped properties over their fair value is added to costs subject to depletion.

### *Office furniture and equipment*

Office furniture and equipment is carried at cost and depreciated on a straight-line basis over the assets' estimated useful lives at a rate of 25% per annum.

### Goodwill

Goodwill represents the excess purchase price over the fair value of identifiable assets and liabilities acquired in business combinations. Goodwill is subject to ongoing annual impairment reviews, or more frequent as economic events dictate, based on the fair value of the Company's assets. The fair value of the Company's assets is determined and compared to the book value of those assets. If the fair value of the assets is less than the book value, then a second test is performed to determine the amount of the impairment. The amount of the impairment is determined by deducting the fair value of the Company's individual assets and liabilities from the fair value of the total assets to determine the implied fair value of goodwill and comparing that amount to the book value of the Company's goodwill. Any excess of the book value over the implied value of goodwill is the impairment amount.

### Leases

Leases are classified as either capital or operating in nature. Capital leases are those which transfer substantially all the benefits and risks of ownership to the lessee. Assets acquired under capital leases are depleted along with the petroleum and natural gas properties. Obligations recorded under capital leases are reduced by the principal portion of lease payments as incurred and the imputed interest portion of capital lease payments is charged to expense and amortized straight-line over the life of the lease. Operating lease payments are charged to expense.

### Asset Retirement Obligations

The Company recognizes the fair value of a liability for an asset retirement obligation and a corresponding increase in the carrying value of the related long-lived asset in the period in which they are constructed or acquired. The fair value of the obligation is management's best estimate of the cost to retire the asset based on current legislation and industry practice. The increase in the carrying value of the asset is amortized on a unit of production basis consistent with the method used to record depletion on the Company's petroleum and natural gas properties. The liability is subsequently adjusted for the passage of time, which is recognized as accretion expense in the statement of operations and deficit. The liability is periodically adjusted for revisions in either the timing or the amount of the original estimated cash flows associated with the obligation. Any difference between the related costs incurred and the recorded liability is recorded as a gain or loss in the statements of operations in the period in which the settlement occurs.

### Measurement Uncertainty

The amounts recorded for depletion and depreciation of petroleum and natural gas properties and other assets, the provision for asset retirement obligations, and the ceiling test calculation are based on estimates of proven or proven and probable reserves, production rates, petroleum and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

### Joint Operations

Substantially all of the Company's exploration and development activities are conducted jointly with others and accordingly the financial statements reflect only the Company's proportionate interest in such activities.

### Flow Through Shares

The Company finances a portion of its exploration and development activities through the issuance of flow through shares. Under the terms of a flow through share issue, the tax attributes of the related expenditures are renounced to subscribers. To recognize the foregone tax benefits to the Company, share capital is reduced and future income taxes are increased by the estimated amount of future income taxes payable when the renouncement is filed with the tax authorities, provided there is reasonable assurance that the expenditures will be made.

### Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, the Company records future income taxes for the difference between the financial statement carrying value and the income tax basis of an asset or liability. Future income tax assets and liabilities are measured using income tax rates and laws that are expected to apply in the periods in which differences are anticipated to reverse. The effect on future tax assets and liabilities of a change in tax rates is recognized in net loss in the period in which the change is substantively enacted.

### Revenue Recognition

Revenues from the sale of petroleum and natural gas and related products are recognized when title passes.

### Stock Based Compensation

The Company has a stock based compensation plan, which is described in note 10. The Company has adopted the fair value based method of accounting for stock options. Stock option expense is recorded as a general and administrative expense for all options granted on or after January 1, 2003, with a corresponding increase recorded to contributed surplus. The fair value of options granted is estimated at the date of grant using the Black-Scholes valuation model. Consideration paid by employees or directors on the exercise of stock options is credited to share capital. At the time of exercise, the related amounts previously credited to contributed surplus are also transferred to share capital.

### Per Share Information

Per share information is calculated using the treasury stock method. Under this method, the diluted weighted average number of common shares is calculated assuming that the proceeds from the exercise of outstanding and in the money options is used to purchase common shares at the estimated average market price.

## 3. CASH AND CASH EQUIVALENTS

As at December 31, 2005, cash and cash equivalents include term deposits with maturities of 90 days or less of $4,980,000. The term deposits earned interest at 2.78%.

## 4. ACCOUNTS RECEIVABLE

A substantial portion of the Company's accounts receivable is with oil and gas marketing entities. The Company generally extends unsecured credit to these companies, and therefore, the collection of accounts receivable may be affected by changes in economic or other conditions and may accordingly impact the Company's overall credit risk. Management believes the risk is mitigated by the size, reputation and diversified nature of the companies to which they extend credit.

The Company has not previously experienced any material credit losses on the collection of receivables. Of the Company's significant individual accounts receivable at December 31, 2005, approximately 65% was owed from seven customers (December 31, 2004 - 83% was owed from six customers).

The accounts receivable balance at December 31, 2005 includes $144,431 owed in the normal course of operations by a joint venture partner which is controlled by one of Cinch's directors.

## 5. PROPERTY, PLANT AND EQUIPMENT

**Property, plant and equipment**

| | December 31, 2005 | | |
|---|---|---|---|
| | Cost $ | Accumulated depreciation $ | Net book value $ |
| Petroleum and natural gas properties | **104,375,911** | **(19,153,951)** | **85,221,960** |
| Equipment under capital lease | **839,303** | **(95,777)** | **743,526** |
| Office furniture and equipment | **215,095** | **(94,664)** | **120,431** |
| | **105,430,309** | **(19,344,392)** | **86,085,917** |

| | December 31, 2004 | | |
|---|---|---|---|
| | Cost $ | Accumulated depreciation $ | Net book value $ |
| Petroleum and natural gas properties | 65,992,834 | (10,012,446) | 55,980,388 |
| Equipment under capital lease | 827,685 | (25,282) | 802,403 |
| Office furniture and equipment | 121,313 | (49,912) | 71,401 |
| | 66,941,832 | (10,087,640) | 56,854,192 |

For the years ended December 31, 2005 and 2004, no indirect general and administrative expenditures were capitalized.

As at December 31, 2005, $11,885,839 of costs related to undeveloped lands were excluded from costs subject to depletion [December 31, 2004- $12,843,595].

**Acquisition**

a) Effective August 4, 2005, the Company acquired all of the issued and outstanding common shares of and wound up 1008742 Alberta Ltd. into Cinch Energy Corp. The certificate of dissolution was received December 21, 2005. The total cash consideration of the purchase was $1.205 million which has been allocated to petroleum and natural gas properties, future taxes and working capital. The acquisition was accounted for using the purchase method and therefore revenues and expenses from the acquired assets have been included in the statements of operations and deficit from August 4, 2005.

The purchase price has been allocated as follows:

| | $ |
|---|---|
| Non-cash working capital | **38,852** |
| Land | **1,421,639** |
| Property, plant and equipment | **93,648** |
| Asset retirement obligation | **(6,678)** |
| Future taxes | **(342,707)** |
| Total purchase price | **1,204,754** |

b) On August 12, 2004, the Company acquired the Canadian petroleum and natural gas properties and related assets of Rio Alto Resources International Inc. ("Rio Alto"), by purchasing the shares of a newly created subsidiary company of Rio Alto, 1099017 Alberta Ltd., holding such assets since the effective date of April 1, 2004, for a purchase price of $48.703 million, or $45.987 million net of working capital acquired. Immediately after the acquisition, the Company amalgamated with 1099017 Alberta Ltd. and continued as Cinch Energy Corp.

The Company financed the acquisition with the proceeds of a subscription receipt and flow through subscription receipt private placement, as more fully described in note 10, and with its credit facility, as described in note 6.

The purchase price was allocated as follows:

| | $ |
|---|---|
| Cash acquired | 4,079,476 |
| Working capital deficiency, excluding cash acquired | (1,362,878) |
| Undeveloped land | 10,000,000 |
| Property, plant and equipment | 25,029,299 |
| Goodwill | 14,616,996 |
| Asset retirement obligation | (975,663) |
| Future taxes | (2,683,563) |
| Total purchase price | 48,703,667 |
| Cash consideration | 48,500,000 |
| Transaction costs | 203,667 |
| Total consideration | 48,703,667 |

The acquisition was accounted for using the purchase method and therefore revenues and expenses from the acquired assets have been included in the statements of operations and deficit from August 12, 2004.

The Company has performed an impairment test as of December 31, 2005 using the estimated average price for each of the next five years as determined by the Company's independent reserve engineers adjusted for differentials specific to the Company's reserves as follows:

| | Natural Gas $/mmbtu Cdn | Natural Gas Liquids $/bbl Cdn |
|---|---|---|
| 2006 | 10.35 | 67.00 |
| 2007 | 9.00 | 65.25 |
| 2008 | 7.75 | 60.50 |
| 2009 | 7.25 | 56.75 |
| 2010 | 6.95 | 55.00 |

Each benchmark price increased by an average of 0% from 2011 to 2012 and 2% from 2013 and thereafter.

## 6. CREDIT FACILITY

Effective June 8, 2005, the Company increased its revolving, demand bank credit facility through ATB Financial to $26,500,000 from $20,000,000 [December 31, 2004 - $18,000,000]. The facility bears interest at the lender's prime rate. The effective interest rate at December 31, 2005 was 4.02% [December 31, 2004 - 4.25%]. As at December 31, 2005, the amount drawn on the credit facility was nil [December 31, 2004 - $9,963,616]. As security for the facility, the Company has provided a general security agreement with the lender constituting a first ranking security interest in all personal property and a first ranking floating charge on all real property of the Company subject only to a subordination agreement to another bank for the amount of, and as security for, a capital lease.

## 7. CAPITAL LEASE OBLIGATION

The Company is committed to annual minimum payments under a capital lease agreement which commenced in December, 2004, as follows:

| *Years ending December 31* | $ |
|---|---|
| 2006 | **232,140** |
| 2007 | **232,140** |
| 2008 | **232,140** |
| Total minimum lease payments | **696,420** |
| Less amounts representing interest at 5.12% | **(65,425)** |
| Present value of minimum lease payments | **630,995** |
| Less current portion | **(210,007)** |
| Capital lease obligation at December 31, 2005 | **420,988** |

For the year ended December 31, 2005, there was $22,274 [2004 - nil] recorded in interest expense relating to capital leases. There is a first charge on the Company's assets as security for the capital lease obligation.

## 8. ASSET RETIREMENT OBLIGATIONS

The total future asset retirement obligations result from the Company's net ownership interest in wells and facilities. Management estimates the total undiscounted amount of cash flows required to reclaim and abandon wells and facilities as at December 31, 2005 is approximately $4,260,000 [December 31, 2004 - $2,636,113], to be incurred over the next 18 years. The Company used a credit adjusted, risk-free rate of 5% and an inflation rate of 2% to arrive at the recorded liability of $2,725,627 [December 31, 2004 - $1,633,234].

The Company's asset retirement obligations changed as follows:

| | **December 31, 2005** | December 31, 2004 |
|---|---|---|
| | **$** | $ |
| Asset retirement obligations, beginning of year | **1,633,234** | 261,485 |
| Liabilities acquired *[note 5]* | **6,678** | 975,663 |
| Liabilities incurred | **927,866** | 314,937 |
| Accretion expense | **157,849** | 81,149 |
| Asset retirement obligations, end of year | **2,725,627** | 1,633,234 |

## 9. FUTURE INCOME TAXES

Income tax recovery differs from the amount that would be computed by applying the Federal and Provincial statutory income tax rates to loss before income taxes. The reasons for the differences are as follows:

| | **December 31, 2005** | December 31, 2004 |
|---|---|---|
| Statutory income tax rate | **37.62%** | 38.62% |
| | **$** | $ |
| Anticipated income taxes | **1,945,506** | 118,130 |
| Increase/(decrease) resulting from: | | |
| Resource allowance | **(1,406,352)** | (459,991) |
| Non-deductible crown royalties, net of Alberta Royalty Tax Credit | **1,160,585** | 423,105 |
| Non-deductible items | **5,512** | 3,262 |
| Stock compensation expense | **208,364** | 98,367 |
| Rate adjustment | **(203,715)** | 10,613 |
| Future income taxes | **1,709,900** | 193,486 |
| Large corporation taxes | **97,650** | 13,150 |
| | **1,807,550** | 206,636 |

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes. The components of the Company's future income tax assets and liabilities are as follows:

| | **December 31, 2005** | December 31, 2004 |
|---|---|---|
| | **$** | $ |
| Net book value of capital assets in excess of tax pools | **(9,663,114)** | **(7,631,292)** |
| Share issue costs | **1,047,675** | **958,811** |
| Asset retirement obligations | **916,356** | **549,093** |
| Other | **52,323** | – |
| Future tax liability | **(7,646,760)** | **(6,123,388)** |

# CINCH ENERGY CORP.

December 31, 2005 and 2004

## 10. SHARE CAPITAL

**Authorized** - Unlimited number of common voting shares without par value

| | December 31, 2005 | | December 31, 2004 | |
|---|---|---|---|---|
| **Issued** | **Number** | **$** | **Number** | **$** |
| ***Common shares*** | | | | |
| Balance, beginning of year | **33,104,316** | **51,568,073** | 5,364,440 | 8,242,356 |
| Issued for cash on warrant exercise *(i,iii)* | **8,022,529** | **19,053,506** | – | – |
| Issued for cash on flow through private placement *(ii)* | **2,352,941** | **9,999,999** | – | – |
| Issued for cash on private placement *(ii)* | **3,676,472** | **12,500,005** | – | – |
| Exercise and conversion of special warrants *(iv)* | **257,600** | **238,759** | 5,790,458 | 6,746,040 |
| Issued for cash on options exercise *(v)* | **100,334** | **188,126** | 70,000 | 131,000 |
| Issued for cash on brokers' warrant exercise *(vi)* | **243,440** | **243,440** | 70,054 | 95,861 |
| Reclassification on exercise of options *(v)* | **–** | **56,473** | – | 11,500 |
| Exercise of flow through subscription receipts *(iii)* | **–** | **–** | 3,333,333 | 6,984,290 |
| Exercise of subscription receipts *(iii)* | **–** | **–** | 17,364,905 | 30,320,386 |
| Issued for cash on private placement *(iii)* | **–** | **–** | 1,111,112 | 2,500,000 |
| Rounding on conversion *(iv)* | **–** | **–** | 14 | – |
| Future taxes on flow through common shares | **–** | **–** | – | (3,362,000) |
| Issue costs, net of future taxes | **–** | **(837,672)** | – | (101,360) |
| Balance, end of year | **47,757,632** | **93,010,709** | 33,104,316 | 51,568,073 |
| ***Special warrants*** | | | | |
| Balance, beginning of year | **312,600** | **272,694** | 6,103,058 | 7,018,734 |
| Exercise and conversion to common shares *(iv)* | **(257,600)** | **(238,759)** | (5,790,458) | (6,746,040) |
| Balance, end of year | **55,000** | **33,935** | 312,600 | 272,694 |
| ***Share capital, end of year*** | **47,812,632** | **93,044,644** | 33,416,916 | 51,840,767 |
| ***Subscription receipts*** | | | | |
| Balance, beginning of year | **–** | **–** | – | – |
| Issued for cash on private placement *(iii)* | **–** | **–** | 43,412,262 | 32,559,197 |
| Issued for cash on flow through private placement *(iii)* | **–** | **–** | 8,333,333 | 7,500,000 |
| Issue costs | **–** | **–** | – | (2,754,521) |
| Exercise and deemed exercise into common shares *(iii)* | **–** | **–** | (51,745,595) | (37,304,676) |
| ***Subscription receipts, end of year*** | **–** | **–** | – | – |
| ***Contributed surplus*** | | | | |
| Balance, beginning of year | **–** | **753,449** | – | 510,244 |
| Non cash compensation expense *(v)* | **–** | **553,866** | – | 254,705 |
| Reclassification to share capital on exercise of options *(v)* | **–** | **(56,473)** | – | (11,500) |
| ***Contributed surplus, end of year*** | **–** | **1,250,842** | – | 753,449 |

Share capital and per share amounts have been restated on a retroactive basis to reflect a 2.5 for 1 common share consolidation which occurred on August 12, 2004.

**Common Shares**

*(i) Warrant exercise*

In 2005, a total of 8,022,529 common shares were issued pursuant to the exercise of warrants (see note *iii*) at an exercise price of $2.375, for gross proceeds of $19,053,506 and 1,649,807 warrants exchangeable for 659,923 common shares expired. There are no warrants outstanding as at December 31, 2005.

*(ii) Private Placement*

On September 8, 2005, the Company issued under private placement a total of 2,352,941 flow through common shares at $4.25 per share for proceeds of $9,999,999 and 3,676,472 common shares at $3.40 per share for proceeds of $12,500,005 before total issues costs of $1,203,880. The tax benefit of the flow through shares was renounced in 2006.

*(iii) Private Placement*

On June 15 and June 17, 2004, the Company issued a total of 1,111,112 flow through common shares at $2.25 per share in a private placement for gross proceeds of $2,500,000.

In accordance with the terms of the flow through common shares, and pursuant to certain provisions of the *Income Tax Act* (Canada), in 2004 the Company renounced, for income tax purposes, exploration and development expenditures to holders of its flow through common shares of $2,500,000.

Under the same private placement, the Company also issued, on June 15, June 17 and July 22, 2004, 43,412,262 subscription receipts at $0.75 per subscription receipt and 8,333,333 flow through subscription receipts at $0.90 per flow through subscription receipt and the gross proceeds were placed in escrow. Each subscription receipt entitled the holder to acquire 0.4 common shares without payment of additional consideration and one half of one warrant, each whole warrant entitling the holder to acquire 0.4 common shares at an exercise price of $2.375 until June 15, 2005. If the common shares or warrants issuable on exercise of the subscription receipts were subject to a restricted period or a hold period (other than in respect of sales by control persons) after November 30, 2004, the holders of subscription receipts were entitled to receive on exercise of the subscription receipts 0.44 common shares and one half of one warrant. Each flow through subscription receipt entitled the holder to acquire 0.4 flow through common shares without payment of additional consideration and was deemed exercised on closing of the acquisition of 1099017 Alberta Ltd. on August 12, 2004, as described in note 5, resulting in the issuance of 3,333,333 common shares.

On August 12, 2004, proceeds from the subscription receipts and flow through subscription receipts totaling $40,059,197 that had been placed in escrow were released to the Company on closing of the acquisition, net of issue costs of $2,754,521.

In accordance with the terms of the flow through subscription receipts, and pursuant to certain provisions of the *Income Tax Act* (Canada), in 2004 the Company renounced, for income tax purposes, exploration and development expenditures to holders of its flow through common shares of $7,500,000.

On October 15, 2004, the Company received a receipt for a final prospectus and the subscription receipts were therefore deemed exercised five business days later, on October 22, 2004. The common shares issued on the deemed exercise of the subscription receipts were not subject to a restricted period or a hold period (other than in respect of sales by control persons), and as such, the holders of subscription receipts received 0.4 common shares and one half of one warrant for each subscription receipt deemed to be exercised. A total of 17,364,905 common shares and 21,706,131 warrants were issued October 22, 2004, with each warrant entitling the holder to acquire 0.4 of a common share at an exercise price of $2.375 until June 15, 2005 as noted in *(i)*.

*(iv) Exercise of special warrants*

Pursuant to the receipt for a final prospectus received on October 15, 2004 as noted in *(iii)*, the common shares issuable on exercise of special warrants outstanding were no longer subject to a restricted period or hold period under applicable securities laws in Canada (other than Quebec). During the year ended December 31, 2005, special warrant holders have exercised 257,600 special warrants in exchange for a total of 257,600 common shares for no additional cash consideration.

During the year ended December 31, 2004, 5,790,458 special warrants (14,476,146 special warrants consolidated on a 2.5 for 1 basis) were exercised in exchange for a total of 5,790,458 common shares.

(v) *Exercise of options*

During the year ended December 31, 2005, a total of 100,334 common shares were issued on exercise of stock options [December 31, 2004 - 70,000] at an average exercise price of $1.875 [December 31, 2004 - $1.875]. As a result, stock compensation expense of $56,473 previously recognized for these options has been reclassified from contributed surplus to common shares [December 31, 2004 - $11,500].

The non-cash compensation expense is comprised of the stock option benefit for all outstanding options.

(vi) *Brokers' warrant exercise*

On January 30, 2005, a total of 50,500 brokers' warrants expired. During the year ended December 31, 2005, a total 243,440 common shares were issued pursuant to the exercise of brokers' warrants at an exercise price of $1.00. [December 31, 2004 - 40,560 common shares at $1.00 and 29,494 common shares at $1.875]. As at December 31, 2005, there were no brokers' warrants outstanding.

**Per share amounts**

Per share amounts have been calculated using the weighted average number of common shares and special warrants outstanding during the year of 40,046,588 [2004 - 20,054,494]. The diluted per share amounts are calculated assuming the exercise of outstanding, in the money options, and future compensation costs to be incurred on outstanding options resulting in a weighted average number of common shares of 41,921,643 [2004 - 22,068,795]. Per share calculations that are anti-dilutive are not presented.

**Stock option plan**

The Company has a stock option plan authorizing the grant of options to purchase shares to designated participants, being directors, officers, employees or consultants. Under the terms of the plan, the Company may grant options to purchase shares equal to a maximum of ten percent of the total issued and outstanding shares and special warrants of the Company. The aggregate number of options that may be granted to any one individual must not exceed five percent of the total issued and outstanding shares and special warrants. Options are granted at exercise prices equal to the estimated fair value of the shares at the date of grant and may not exceed a ten year term. The vesting for options granted occurs over a three year period, with one third of the number granted vesting on each of the first, second, and third anniversary dates of the grant unless otherwise specified by the Board of Directors at the time of grant.

The following is a continuity of stock options for which shares have been reserved:

| | | 2005 | | 2004 |
|---|---|---|---|---|
| | **Number of Options** | **Weighted Average Exercise Price** | Number of Options | Weighted Average Exercise Price |
| | | $ | | $ |
| Stock options outstanding, beginning of year | **1,635,000** | **1.88** | 658,000 | 1.89 |
| Granted | **1,065,000** | **2.55** | 1,087,000 | 1.87 |
| Exercised | **(100,334)** | **1.88** | (70,000) | 1.88 |
| Expired | **(271,666)** | **2.00** | (40,000) | 1.88 |
| Stock options outstanding, end of year | **2,328,000** | **2.17** | 1,635,000 | 1.88 |

Stock options outstanding at the end of the year are comprised of the following weighted average prices:

| December 31, 2005 Number of Options | December 31, 2005 Weighted Average Exercise Price | December 31, 2004 Number of Options | December 31, 2004 Weighted Average Exercise Price |
|---|---|---|---|
| | $ | | $ |
| — | — | 40,000 | 1.63 |
| 762,000 | 1.87 | 842,000 | 1.87 |
| 531,000 | 1.88 | 678,000 | 1.88 |
| 15,000 | 1.95 | 55,000 | 1.95 |
| 75,000 | 2.04 | — | — |
| 75,000 | 2.14 | — | — |
| 70,000 | 2.29 | — | — |
| 20,000 | 2.38 | 20,000 | 2.38 |
| 25,000 | 2.44 | — | — |
| 556,000 | 2.52 | — | — |
| 25,000 | 2.70 | — | — |
| 49,000 | 2.75 | — | — |
| 125,000 | 3.30 | — | — |
| 2,328,000 | 2.17 | 1,635,000 | 1.88 |

The options outstanding at December 31, 2005 have a weighted average remaining contractual life of 3.7 years [December 31, 2004 - 4.0 years]. As at December 31, 2005, a total of 630,666 were exercisable [December 31, 2004 - 332,667].

The fair value of stock options granted to employees, directors and consultants during the year ended December 31, 2005 and 2004, was estimated on the date of grant using the Black Scholes option pricing model with the following weighted average assumptions: dividend yield of zero percent [2004 - zero percent], expected volatility of 34.62 percent [2004 - 29.25 percent], risk-free interest rate of 3.43 percent [2004 - 3.69 percent], and an expected life of four years [2004 - four years]. Outstanding options granted during the year ended December 31, 2005 had an estimated weighted average fair value of $0.83 per option [December 31, 2004 - $0.53 per option], for a total estimated value of $827,890 [2004 - $558,451]. A total of $553,866 [2004 - $254,705] has been recognized as stock compensation expense with an offsetting credit to contributed surplus for the year ended December 31, 2005.

## 11. COMMITMENTS

The Company has entered into an operating lease for office premises expiring on November 20, 2009 which requires minimum monthly payments of $13,534 to November 30, 2006 and minimum monthly payments of $14,520 thereafter.

The Company has also entered into a capital lease obligation, as more fully described in note 7. The Company has no other arrangements which are deemed to constitute a lease obligation either in form or substance.

## 12. FINANCIAL INSTRUMENTS

### Fair value of financial instruments

Financial instruments recognized on the balance sheet consist of cash and cash equivalents, accounts receivable, deposits, accounts payable, credit facility, and capital lease obligations. As at December 31, 2005 and 2004, there were no significant differences between the carrying amounts of these financial instruments reported on the balance sheet and their estimated fair values. It is management's opinion that the Company is not exposed to significant credit risk.

### Interest rate risk

The Company is exposed to minimal interest rate risk relating to investment income earned on term deposits.

### Commodity price risk management

At December 31, 2005, the Company had no fixed price contracts associated with future production.

## 13. BASIS OF PRESENTATION

Certain of the comparative figures have been reclassified to conform to the presentation adopted in the current year.

corporate
# INFORMATION

## BOARD OF DIRECTORS

**John W. Elick**(3)
*Chief Executive Officer, Cinch Energy Corp.*

**George Ongyerth**(2)
*President, Cinch Energy Corp.*

**Sid W. Dykstra**(2), (3)
*President and Chief Executive Officer of OPTI Canada Inc.*

**William D. Robertson**(1), (2), (4)
*Director, Cinch Energy Corp.*

**Clarence K. Wagenaar**(1), (3)
*Managing Director of All Investments Ltd. and Hillcrest Investments Ltd.*

**Gerald M. Deyell, Q.C.**(1), (4)
*Retired Partner of and Consultant to Blake, Cassels & Graydon LLP*

(1) Member of the Audit Committee
(2) Member of the Reserves Committee
(3) Member of the Compensation Committee
(4) Member of the Governance Committee

## OFFICERS

**John W. Elick**
*Chief Executive Officer*

**George Ongyerth**
*President*

**Brian J. McBeath**
*Vice President, Exploration*

**Denise A. Ramage**
*Chief Financial Officer*

**Brent F. Gess**
*Vice President, Engineering*

**Marcus McLafferty**
*Vice President, Land*

**C. Steven Cohen**
*Secretary*

**Sarah Tait**
*Controller*

## REGISTRAR AND TRANSFER AGENT

**Olympia Trust Company**

2300, 125 - 9th Avenue SE
Calgary, Alberta T2G 0P6
*www.olympiatrust.com*

## BANKERS

**ATB Financial**

239 - 8th Ave
Calgary, Alberta T2P 1C4
*www.atb.com*

## AUDITORS

**Ernst & Young LLP**

Suite 1000, Ernst & Young Tower
440 - 2nd Avenue SW
Calgary, Alberta T2P 5E9
*www.ey.com/ca*

## INDEPENDENT ENGINEERS

**GLJ Petroleum Consultants Ltd.**

4100, 400 - 3rd Avenue SW
Calgary, Alberta T2P 4H2
*www.glja.com*

## LEGAL COUNSEL

**Burnet Duckworth & Palmer LLP**

1400, 350 - 7th Avenue SW
Calgary, Alberta T2P 3N9
*www.bdplaw.com*

www.cinchenergy.com

**CINCH ENERGY CORP.**
Suite 2000, 840 - 7th Avenue SW
Calgary, Alberta T2P 3G2

Phone (403) 693-0090
Fax (403) 693-0191

*www.cinchenergy.com*